# SUPREME COURT OF THE UNITED STATES

## OCTOBER TERM, 1933

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## No. 225

## GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

## OTTO H. FALK ET AL., EXECUTORS OF THE ESTATE OF CHARLES F. PFISTER, DECEASED

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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1 Charles F. Pfister, Amended Title, Otto H. Falk, Jos. E. Uihlein, Chas. P. Vogel & Louis Quarles, Exec. of the Est. of Chas. F. Pfister, deceased. See order of October 3, 1931. *Petitioner,*

*vs.*

Commissioner of Internal Revenue, *Respondent.* } Docket No. 28070.

Appearances:

For Taxpayer: Chas. F. Fawsett, Esq., R. S. Doyle, Esq.

For Comm'r.: P. A. Bayer, Esq.

DOCKET ENTRIES.

1927

May 5—Petition received and filed. Taxpayer notified.

May 6—Copy of petition served on General Counsel.

Jul. 5—Motion for extension of time to Nov. 2, 1927 to answer, filed by General Counsel.

Jul. 6—Granted. Both sides notified.

Oct. 25—Answer filed by General Counsel.

Oct. 27—Copy of answer served on taxpayer. General Calendar.

1929

Aug. 13—Hearing set Nov. 25, 1929.

Aug. 30—Notice of the appearance of R. S. Doyle, attorney for taxpayer.

Aug. 30—Motion to place on Reserve Calendar, filed by taxpayer. Sep. 4, 1929 granted.

1930

Jan. 4—Hearing set Feb. 26, 1930.

Feb. 19—Motion for continuance to April 28, 1930 filed by taxpayer. (34678)

Feb. 20—Motion granted and set for hearing on April 28, 1930.

Apr. 23—Motion for continuance to May 21, 1930 filed by taxpayer. April 25, 1930 granted to May 21, 1930.

Apr. 28—Motion to place on Field Calendar filed by taxpayer. April 30, 1930 granted.

May 21—Hearing set July 8, 1930, Milwaukee, Wisc.

Jul. 8—Hearing had before Stephen J. McMahon, Div. 16 on merits. Stipulation of facts received. Consolidated with Dkts. 34678, 35815, 34758, 34759, 40426 & 41089. Briefs due Oct. 1, 1930.

Jul. 25—Transcript of hearing of July 8, 1930, filed.

Sep. 10—Motion for extension to Nov. 1, 1930 to file brief, filed by taxpayer. Sept. 11, 1930 granted.

Oct. 1—Brief filed by General Counsel.

Oct. 21—Motion for extension to Dec. 1, 1930 to file brief, filed by taxpayer. Oct. 22, 1930 granted.

Nov. 14—Brief filed by taxpayer.

1931

Oct. 3—Order amending title to read Otto H. Falk, Jos. E. Uihlein, Chas. P. Vogel and Louis Quarles, Exe. of the Est. of Chas. F. Pfister, deceased, entered.

Oct. 7—Findings of fact and opinion rendered. Stephen J. McMahon, Div. 16. Judgment will be entered for the respondent.

Oct. 9—Decision enterel. Stephen J. McMahon Div. 16.

2 1932.

Feb. 24—Stipulation consolidating dockets 34678, 34758, 34759, 35815, 40426 and 41089 for the petition for review, filed.

Feb. 24—Petition for review by U. S. Circuit Court of Appeals (7) with assignments of error filed by taxpayer.

Feb. 24—Proof of service filed.

Feb. 24—Praecipe with proof of service thereon filed.

27. 9 * * * (Caption 28070) * *

PETITION,

Filed May 5, 1927.

The above named petitioner hereby petitions for redetermination of the proposed deficiency in tax of $848.30 against him for the year 1922 set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols IT:PA: 4-60D FAL) dated March 7, 1927, and as the basis of his proceeding alleges as follows:

I.

Your petitioner is a citizen of the state of Wisconsin with his residence at the city of Milwaukee and his post office address, 425 East Water Street in said city of Milwaukee, state of Wisconsin.

10

II.

The notice of deficiency (a copy of which is attached and marked Exhibit "A") referred to above was mailed to the petitioner on the 7th day of March, 1927.

III.

The taxes in controversy are income and profits taxes claimed to be due from petitioner for the calendar year 1922 and the amount of such taxes in dispute is the entire amount claimed as the deficiency in said notice, to-wit, the sum of $848.30.

IV.

The determination of tax set forth in said notice is based upon the following error, namely:

The commissioner erred in disallowing the deduction of $15,954.91 claimed in the return filed by Pfister, Smith & Mariner, Trustees, for the year 1922 as depletion of the iron ore mine which was the subject of the trust and of which trust the petitioner was one of the beneficiaries with the result that his share of the taxable income from said trust was increased to the extent which resulted in said deficiency in tax.

11

V.

The facts upon which the petitioner relies as the basis of this proceeding are as follows:

In the year 1922 and prior thereto, a certain iron ore mine located in the state of Michigan known as the Bristol mine was held in trust by your petitioner and two other trustees under which petitioner as one of the beneficiaries was entitled to one-eighth of the net income of said trust. Said mine so held in trust during said year 1922 and for a number of years prior thereto was subject to a lease, the term of which extended for a number of years beyond the year 1922. The sole income derived by the trustees from said mine as the owners of the fee thereof or which they could derive therefrom under the terms of said lease was the royalties payable under said lease by the lessee thereof.

In or about the month of February, 1925, the basis of valuation of said mine for purposes of depletion was revised and redetermined by mineral section and other representatives of the Income Tax Unit of the Treasury Department, as the result of which the basis of such valuation for the purpose of depletion was determined as follows:

12

| | | | |
|---|---|---|---|
| Ore reserve 3/1/13 | | | 3,556,732 Tons |
| Mined 3/1/13 to 11/29/16 | | | |
| 1913 | | 379,170 | |
| 1914 | | 172,006 | |
| 1915 | | 378,830 | |
| 1916 | | 462,800 | 1,392,806 |
| Ore reserve 11/29/16 | | | 2,163,926 |
| Royalty rate—19 cents | | | |
| Gross expected royalty | | | $411,146.94 |
| Less 3% expected expense | | | 12,334.37 |
| Net expected profit | | | 398,811.57 |
| Factor—6%—4%—9 years— .719198 | | | |
| None removed from Nov. 29, 1916 to Jan. 1, 1917 | | | |
| Value of royalties as at Jan. 1, 1917 | | | 286,824.48 |
| Less — 1917 | 188,689 Tons | $25,010.35 | |
| 1918 | 245,280 | 32,511.37 | |
| 1919 | 58,138 | 7,706.07 | |
| 1920 | 368,488 | 48,842.35 | |
| 1921 | 13,555 | 1,796.69 | 115,866.83 |
| | 874,150 | | |
| Residual value—1,289,770 tons at .13255 | | | 170,957.65 |

Thereafter, on March 17, 1925, the trustees received a letter from the Commissioner (Bureau Symbols IT:PA:3 EPR:301) giving the results of a reaudit of the trustees' returns for the years 1917 to 1921 inclusive based on the above basis of valuation and rates for depletion.

Thereafter, to-wit, on the 6th of April, 1925, the trustees filed an amended return for the year 1922 on the basis of said revised valuation and depletion rates determined as aforesaid claiming a deduction of $.13255 per ton for depletion in strict accordance with said determination by the department as above stated, and as petitioner is informed and believes said trust was in law and in fact entitled to such allowance for

13 depletion. Such amended return on the basis of said allowance for depletion showed your petitioner's share of the taxable income from said trust for the year 1922 to be $742.68 which as petitioner is informed and believes was in fact the true amount of his share of the net taxable income of said trust for the year 1922.

In the determination of the tax liability of petitioner for

the year 1922 as shown by said Exhibit "A" and the statement made a part thereof hereto annexed, the entire deduction claimed by said trustees for depletion for the year 1922 was disallowed, and as petitioner is informed and believes the deficiency in tax claimed in said notice results solely from such erroneous disallowance of said deduction for depletion.

Wherefore petitioner prays that this Board may hear this proceeding and redetermine the tax liability of petitioner for the said year 1922 on the basis of the facts and the claims of this petitioner as stated herein and that the Board grant to the petitioner such other and further relief in the premises to which we may be entitled.

CHARLES F. FAWSETT
*Counsel for Petitioner.*

P. O. Address: Room 928—425 East Water St.
Milwaukee, Wisconsin.

14 State of Wisconsin, }
Milwaukee County. } ss.

CHARLES F. PFISTER being duly sworn says that he is the petitioner making the foregoing petition; that he has read said petition and is familiar with the statements contained therein and that the facts therein stated are true except as to those stated to be on information and belief and those facts he believes to be true.

CHARLES F. PFISTER

Subscribed and sworn to before me this 2nd day of May, A. D. 1927.

(Notarial Seal)

OSCAR E. NELL
*Notary Public, Milwaukee County, Wisconsin.*

15

TREASURY DEPARTMENT
Washington

IT:PA:4-60D. Mar. 7, 1927.
FAL
Mr. Charles F. Ffister,
1210 First Wisconsin National Bank Building,
Milwaukee, Wisconsin.

Sir:

A reaudit of your return for the year 1922 discloses a deficiency in tax of $848.30. The adjustments made are shown in the attached statement.

In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not doe so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C. for the attention of IT:PA:4-60D,FAL. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR,
*Commissioner.*
By C. R. NASH
*Assistant to the Commissioner.*

Inclosures:
Statement
Form A
Form 882

16

Mar. 7, 1927.

Statement.

IT:PA:4-60D
FAL

*In re*: Mr. Charles F. Pfister,
1210 First Wisconsin National Bank Bldg.,
Milwaukee, Wisconsin.

| Year | Deficiency in Tax |
|---|---|
| 1922 | $848.30 |

Reference is made to the report of the examining officer, dated May 14, 1925, covering an investigation of your books of account and records for the year 1922. An examination of the report discloses income of $742.68 from Pfister, Smith and Mariner, trustees, and a total net income of $89,073.49.

You are advised that information now on file in this office discloses that your distributive share of the income from the trustees is $2,737.02 instead of the amount shown in the report.

The increase results from the disallowance of the deduction of $15,954.91 claimed on the return filed by the trustees for depletion, since information on file in this office does not disclose that the trust meets the provisions of Treasury Decision 2267—ARR 3959 and I. T. 2218. The adjusted income of the trust is $21,896.17 ($5,941.26, shown in the report, plus $15,954.91, depletion disallowed) and your distributive share is $2,737.02 instead of $742.68 shown in the report. As a result of this adjustment your net income is $91,067.83.

The tax has been computed as follows:

| | | |
|---|---|---|
| Net Income | | $91,067.83 |
| Less: | | |
| Personal exemption | $1,000.00 | |
| Dividends | 97,513.73 | 98,513.73 |
| Income subject to normal tax | | None |
| Surtax on $91,067.83 | | 18,419.17 |
| Credit tax paid at source | | 18.40 |
| Balance | | 18,400.77 |
| 17 Tax previously assessed | 16,399.34 | |
| Plus additional tax | 1,153.13 | 17,552.47 |
| Deficiency in Tax | | 848.30 |

Payment of the deficiency in tax should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

18. *In re:* Mr. Charles F. Pfister,
Milwaukee, Wisconsin.

Form A

Waiver of Right to File a Petition With the U. S. Board of Tax Appeals.

The undersigned taxpayer hereby waives the right to file a petition with the U. S. Board of Tax Appeals under Section

274 (a) of the Revenue Act of 1926 and consents to the assessment and collection of a deficiency in tax for the year 1922 aggregating $848.30.

Mar. 7, 1927.

.....
(Name)

.....
(Address)

Date .....

By .....

Note: This waiver does not extend the statute of limitations for refund or assessment of tax, and is not an agreement as provided under Section 1106 of the Revenue Act of 1926.

1927. 19 • • (Caption 28070) • •

## ANSWER.

Filed Oct. 25, 1927.

Now comes the Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and for answer to the petition of this taxpayer, admits and denies as follows:

I.

Admits the allegations of fact contained in paragraph I of the petition.

II.

Admits the allegations of fact contained in paragraph II of the petition.

III.

Admits the allegations of fact contained in paragraph III of the petition.

IV.

Admits that the Commissioner disallowed a deduction of $15,954.91, claimed on a return filed by Pfister, Smith & Mariner, Trustees, for the year 1922, as depeltion of an iron ore mine, but denies that he erred in so doing, and further denies that he erred in the determination of said deficiency in any manner whatsoever.

V.

Admits that the petitioner is a beneficiary under a certain trust and is entitled to one-eighth of the net income of said trust for the year 1922.

Denies generally and specifically each and every allegation of error or of fact contained in the taxpayer's petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the taxpayer's appeal be denied.

C. M. CHAREST,
*General Counsel,*
*Bureau of Internal Revenue.*

Of Counsel:
JOSEPH B. HARLACHER,
*Special Attorney,*
*Bureau of Internal Revenue.*

3 Otto H. Falk, Joseph E. Uihlein, Charles P. Vogel & Louis Quarles, Executors of Last Will & Testament of Charles F. Pfister,
*Petitioners,*
*vs.*
Commissioner of Internal Revenue,
*Respondent.*
} Docket No. 34678.

Appearances:

For Taxpayer: C. F. Fawsett, Esq., R. S. Doyle, Esq.

For Comm'r.: P. A. Bayer, Esq.

DOCKET ENTRIES.

1928

Feb. 6—Petition received and filed. Taxpayer notified. (Fee paid)

Feb. 7—Copy of petition served on General Counsel.

Mar. 6—Answer filed by General Counsel.

Mar. 10—Copy of answer served on taxpayer. General Calendar.

1929

Aug. 30—Notice of the appearance of R. S. Doyle, attorney for taxpayer. See 28070.

Nov. 18—Hearing set Jan. 28, 1930.

Dec. 10—Motion to place on the Reserve Calendar, filed by taxpayer. December 11, 1929 granted.

1930

Jan. 4—Hearing set Feb. 26, 1930.

Feb. 19—Motion to continue to April 29, 1930 filed by taxpayer. Feb. 20, 1930 granted and set for hearing April 28, 1930.

Apr. 23—Motion to continue to May 21, 1930 filed by taxpayer. See 28070. Apr. 25, 1930 granted to May 21, 1930.

Apr. 28—Motion to place on Field Calendar filed by taxpayer. April 30, 1930 granted.

May 21—Hearing set July 8, 1930 at Milwaukee, Wisc.

Jul. 8—Hearing had before Stephen J. McMahon, Div. 16 on merits. Consolidated with 35815, 34758, 37459, 40426, 41089. Stipulation of facts received. Briefs due Oct. 1, 1930.

Jul. 25—Transcript of hearing of July 8, 1930 filed.

Sep. 10—Motion for extension to Nov. 1, 1930 to file brief, filed by taxpayer. September 11, 1930 granted.

Oct. 1—Brief filed by General Counsel.

Oct. 21—Motion for extension to Dec. 1, 1930 to file brief, filed by taxpayer. October 22, 1930 granted.

Nov. 14—Brief filed by taxpayer.

1931

Oct. 7—Findings of fact and opinion rendered, S. J. McMahon, Div. 16. Judgment will be entered for respondent.

Oct. 9—Decision entered, Stephen J. McMahon, Div. 16.

1932

Feb. 24—Stipulation consolidating dockets 28070, 34678, 34758, 34759, 35815, 40426 and 41089 for petition for review filed.

Feb. 24—Petition for review to U. S. Circuit Court of Appeals (7) with assignments of error filed by taxpayer.

Feb. 24—Proof of service filed.

Feb. 24—Praecipe filed, proof of service thereon.

21 * * (Caption 34678) * *

## PETITION.

Filed Feb. 6, 1928.

The above named petitioners hereby petition for redetermination of the proposed deficiency in tax of $2,065.93 against Charles F. Pfister for the year 1923 set forth by the Commissioner of Internal Revenue in his notice or deficiency (IT:

FAR:B-2 MLR-60D) dated December 10, 1927, and as a basis of their proceeding alleges as follows:

I. The above named Charles F. Pfister died at the city of Milwaukee on the 12th day of November, 1927, being at the time of his death a resident and citizen of the city of
22 Milwaukee, state of Wisconsin, and leaving a last will and testament. Thereafter said will was admitted to probate and was duly probated in and by the county court of Milwaukee County, Wisconsin, and petitioners named therein as executors were duly appointed and qualified as such and ever since have been the duly appointed, qualified and acting executors of the said last will and testament of the said Charles F. Pfister.

II. The notice of deficiency, a copy of which is attached and marked Exhibit "A" referred to above is dated December 10, 1927, and was on that date mailed to the said Charles F. Pfister.

III. The taxes in controversy are income and profits taxes claimed to be due from the said Charles F. Pfister for the calendar year 1923 and the amount of such taxes in dispute is the entire amount claimed as a deficiency in said notice, to-wit, the sum of $2065.93.

IV. The determination of tax set forth in said notice is based upon the following errors, namely:

(1) The Commissioner erred in disallowing the deduction of $60,279.76 claimed in the return filed by Pfister, Smith
23 and Mariner, for the year 1923, as depletion of an iron ore mine which was the subject of the trust referred to in said return and of which trust the said Charles F. Pfister was one of the beneficiaries with the result that $7,534.97 was erroneously added to the taxable income of the said Charles F. Pfister for the year 1923 as shown by Exhibit "A" hereto annexed. A copy of the notice of the Commissioner to the said Pfister, Smith & Mariner, Trustees, dated December 10, 1927, disallowing said claimed deduction of $60,279.76 which resulted in said deficiency shown in said Exhibit "A" hereto annexed, is attached hereto marked Exhibit "B" and made part hereof.

(2) The Commissioner erred in determining that there is any deficiency tax due from said Charles F. Pfister for the year 1923.

V. The facts upon which petitioners rely as the basis of this proceeding are as follows:

(a) In the year 1923 and prior thereto a certain iron ore

mine located in the state of Michigan known as the Bristol Mine was held in trust by the said Charles F. Pfister and two other trustees under which the said Charles F. Pfister
24 was one of the beneficiaries.

(b) The provisions of the trust conveyance by which said trust was created in so far as material to this proceeding were in substance as follows:

Said instrument was made, executed and delivered November 29, 1916, by which certain real estate in Michigan including said mine was conveyed to the trustees of which the said Charles F. Pfister was one, in trust, with full powers of sale, management and control and providing that after the payment of costs of administration and prior charges,

"All proceeds which shall come to the hands of the trustees from said property or from any use which may be made thereof, or from any source whatsoever hereunder as received by the trustees shall belong to and be the property of the beneficaries hereunder, to be distributed and paid over to them in proportion to and in accordance with their respective interests as shown herein or as the same shall from time to time appear as hereinafter provided.

The beneficiaries of the trust hereby created and hereinbefore referred to and their respective interests hereunder at the time of the execution and delivery of this instrument are as follows:

| | |
|---|---|
| Jesse Hoyt Smith— | 1/4 |
| Lucinda W. Mariner— | 1/8 |
| John W. Mariner | 1/8 |
| Charles F. Pfister | 1/8 |
| Louise F. Vogel | 1/8 |
| Executors and trustees under the last will and testament of Jesse Hoyt, deceased— | 1/4" |

25 (c) At the time of the execution of said trust conveyance, to-wit, November 29th, 1916, said Bristol Mine was subject to a mining lease for term of upwards of 15 years, exceeding the life of said mine on the basis of estimated ore reserves and the established rules for determining the life of said mine, so that during the term of said lease it could be assumed that all of the ore in said mine would be taken out and disposed of under said lease.

(d) The sole income and entire proceeds derived from the trust estate since the execution of said trust conveyance has been the royalties payable by the lessees under said lease to the owners of the fee, who after said trust conveyance were

the trustees under said conveyance. The royalty rate reserved in said lease was 19 cents per ton.

(e) In or about the month of February, 1925, in connection with the audit of the accounts of the trustees for the years 1917, 1918, 1919, 1920 and 1921 the basis of valuation of said Bristol Mine for purposes of depletion was revised and redetermined by the mineral section and other representatives of the Income Tax Unit of the Internal Rev-
26 enue Department in conference with duly authorized representatives of said trustees with the result that the basis of valuation of said mine for purposes of depletion was determined by the department as follows:

| | | | |
|---|---|---|---|
| Ore reserve 3/1/13 | | | 3,556,732 Tons |
| Mined 3/1/13 to 11/29/16 | | | |
| 1913 | 379,170 | | |
| 1914 | 172,006 | | |
| 1915 | 378,830 | | |
| 1916 | 462,800 | | |
| | | | 1,392,806 |
| Ore reserve 11/29/16 | | | 2,163,926 |
| Royalty rate—19 cents | | | |
| Gross expected royalty | | | $411,146.94 |
| Less 3% expected expense | | | 12,334.37 |
| Net expected profit | | | 398,811.57 |
| Factor—6%—4%—9 years—.719198 | | | |
| None removed from Nov. 29, 1916 to Jan. 1, 1917 | | | |
| Value royalties as at Jan. 1, 1917 | | | 286,824.48 |
| Less—1917 | 188,689 Tons | $25,010.35 | |
| 1918 | 245,280 | 32,511.37 | |
| 1919 | 58,138 | 7,706.07 | |
| 1920 | 368,488 | 48,842.35 | |
| 1921 | 13,555 | 1,796.69 | 115,866.83 |
| | 874,150 | | |
| Residual value—1,289,776 tons at .13255 | | | 170,957.65 |

(f) Said basis of valuation as so determined by the Income Tax Unit was proposed to the representatives of said trustees for acceptance in settlement of the controversy in relation to the matter then pending before said Income Tax Unit and was accepted and expressly agreed to on behalf of said trustees with the understanding that such settlement and

determination was subject to the approval of the Commissioner.

27 (g) Thereafter on March 17, 1925, the trustees received a letter from the Commissioner (IT:PA:3 EPR: 301) confirming said determination and basis of valuation for purposes of depletion and advising the trustees of the results of the audit by the Department of their books and accounts for income tax purposes for the years 1917 to 1921 inclusive based on said determination and upon the rates for depletion shown therein.

(h) After the receipt of said letter of March 17, 1925, confirming said settlement and determination of the basis of valuation of said mine for purposes of depletion, the trustees filed returns for the years 1922, 1923 and 1924 on the basis of said determination claiming a deduction of .13255 cents per ton for depletion in accordance therewith and the depletion claimed by them in their said amended return for the year 1923 in accordance with said determination and to which as they are informed and believe, they were lawfully entitled was the sum of $60,279.76.

(i) The facts upon which said rate of depletion was based shown in the statement and computation above referred to, as petitioners are informed and believed, were substantially correct and entitled said trustees to the rate of depletion therein stated, to-wit, .13255 cents per ton.

28 (j) The ore taken from said mine under said lease for the year 1923 was 454,770 tons which at the rate of depletion established as aforesaid entitled the said trustees to a deduction of $60,279.76.

(k) Since the execution of said trust conveyance it has been the practice of the trustees thereunder as authorized and required by the terms thereof to make distribution of the entire royalties received by them under said lease from time to time among the beneficiaries of said trust in accordance with their respective interests as before stated after paying or reserving costs of administration and prior charges without reserving from such distribution the portion of such royalties corresponding to the proper allowance for depletion.

(l) In the year 1925 the income and profits tax return of the said Charles F. Pfister for the year 1923 was duly audited by the Department of Internal Revenue and in determining the taxable income of the said Charles F. Pfister for that year derived by him from said trust, the deduction of $60,-

29 279.76 taken by said trustees for depletion as aforesaid was accepted and confirmed, and based thereon an addi-

tional tax for said year 1923 was assessed against the said Charles F. Pfister in the sum of $17,123.00 which was paid by the said Charles F. Pfister on or about the 15th of December, 1925.

(m) Notwithstanding the foregoing, in the year 1927 the Commissioner undertook to reopen the audit of said return of the said Charles F. Pfister for the year 1923 and upon such reaudit erroneously disallowed the entire deduction claimed by said trustees for depletion for said year 1923 with the result that $7,534.97 was added to the taxable income of the said Charles F. Pfister for the year 1923 resulting in said deficiency in tax of $2,065.93 referred to in said notice of deficiency.

(n) Petitioners allege upon information and belief that said sum of $7,534.97 added to the taxable income of said Charles F. Pfister for the year 1923 as aforesaid was not in law or in fact income but represented to that extent a return to the said Charles F. Pfister by the trustees under said trust conveyance of his share of the corpus of the trust estate held by said trustees and that such addition to the taxable income was erroneous.

30 (o) Petitioners further allege upon information and belief that by reason of the facts hereinbefore stated the determination of the valuation of said mine for purposes of depletion and the depletion rate as aforesaid and the audit of the return of the said Charles F. Pfister for 1923 made in the year 1925 and the payment of the additional assessment based on said audit as aforesaid should be held to be binding and conclusive upon the Commissioner, and that the reopening of said audit in the year 1927 was erroneous and without justification.

Wherefore petitioners pray that this Board hear this proceeding; that the deduction for depletion taken by said trustees for the year 1923 be affirmed and allowed and that the tax liability of the said Charles F. Pfister and of the petitioners for said year 1923 be redetermined accordingly, and that it be determined that the petitioners or the estate of the said Charles F. Pfister are not liable for any deficiency in tax for said year 1923.

CHARLES F. FAWCETT
*Counsel for Petitioners.*
P. O. Address: 425 West Water Street
Milwaukee, Wisconsin.

31 State of Wisconsin, }
Milwaukee County. }

OTTO H. FALK being first duly sworn deposes and says that he is one of the executors of the last will and testament of Charles F. Pfister, deceased, and one of the petitioners making the foregoing petition; that he makes this verification for himself and on behalf of his co-executors and petitioners, and is duly authorized so to do; that he has read said petition and is familiar with the contents thereof and that all the statements of fact therein contained are true to the knowledge of this affiant except as to matters therein stated on information and belief and as to those matters he believes them to be true.

OTTO H. FALK

Subscribed and sworn to before me this 3 day of February, 1928.

OSCAR E. NELL
(Seal) *Notary Public, Milwaukee County, Wisconsin.*

32 EXHIBIT "A"

TREASURY DEPARTMENT
Washington

IT:FAR:B-2 Dec. 10, 1927.
MLR-60D
Mr. Chas. F. Pfister,
1210 First National Bank Building,
Milwaukee, Wisconsin.

Sir:

The determination of your tax liability for the year 1923 discloses a deficiency of $2,065.93, as shown by the attached statement.

In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C. and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a

petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the enclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C. for the attention of IT:FAR:B-2, MLR-60D.

In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,
D. H. BLAIR,
By C. B. ALLEN,
*Deputy Commissioner.*

Enclosures:
Statement
Form A
Form 882

33

Statement.

Dec. 10, 1927.

IT:FAR:B-2
MLR-60D

*In re:* Mr. Chas. F. Pfister,
1210 First National Bank Building,
Milwaukee, Wisconsin.

| Year | Deficiency in Tax |
|---|---|
| 1923 | $2065.93 |

Your taxable net income as previously adjusted by an Internal Revenue Agent has been further increased as follows:

| | | |
|---|---|---|
| Total net income per Revenue Agent's Report dated May 14, 1925 | | $167,767.43 |
| Capital net gain taxable at 12½% | | 93,391.82 |
| Ordinary net income per Revenue Agent's Report | | $ 74,375.61 |
| Add: | | |
| Increase in distributive income, Pfister, Smith and Mariner | | 7,534.97 |
| Ordinary net income as adjusted | | 81,910.58 |
| Less: | | |
| Personal exemption | $ 1,000.00 | |
| Dividends | 99,807.52 | 100,807.52 |
| Balance for normal tax | | none |
| Surtax on $81,910.58 | | 14,686.02 |
| Tox on capital net gain 12½% of $93,391.82 | | 11,673.97 |
| Total | | 26,359.99 |
| Less: 25% reduction Revenue Act 1924 | 6,589.99 | |
| Tax paid at source | 20.03 | 6,610.02 |
| Net tax assessable | | 19,749.97 |
| Previously assessed: | | |
| Original | 21,295.65 | |
| 25% reduction Revenue Act 1924 | 5,323.91 | |
| | 15,971.74 | |
| Additional deficiency to be assessed | 1,712.30 | 17,684.04 |
| | | 2,065.93 |

34 The increase in distributive income from Pfister, Smith and Mariner is in accordance with the adjustment of the trust's return for 1923 and results from the disallowance of the deduction claimed for depletion which has been fully explained in a letter addressed to the Trustees.

Payment of the deficiency in tax should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

35

## EXHIBIT "B."

TREASURY DEPARTMENT
Washington

IT:FAR:B-2 Dec. 10, 1927.
MLR

Pfister, Smith and Mariner, Trustees,
133 Mason Street,
Milwaukee, Wisconsin.

Sirs:

A review of your 1923 return of income, Form 1041, has been completed in connection with an examination of your books of account and records.

The report of the Internal Revenue Agent in Charge at Milwaukee, Wisconsin, dated November 28, 1925, has been reviewed and approved for 1923 with the following exception:

It is found that depletion is not deductible from the distributive income of the trust since the terms of the trust agreement do not appear to meet the requirements outlined in Treasury Decision 2267, ARR 3959 (Cumulative Bulletin II-2, Page 162) and IT:2218 (Cumulative Bulletin III-2, Page 61).

The amount of $60,279.76 deducted for depletion is therefore added to the net income reported in the amended Form 1041, resulting in a revised distributive income of $128,536.66 which will be apportioned among the beneficiaries as follows:

| | |
|---|---|
| Chas. F. Pfister | $16,067.08 |
| Elmwood Company of Delaware | 16,067.08 |
| Ida Lane Smith | 32,134.16 |
| J. W. Mariner | 32,134.16 |
| A. M. Hoyt and Company | 25,707.34 |
| Alice C. Dane | 6,426.84 |

The beneficiaries will be duly notified of the adjustment in their individual income.

Respectfully,
C. B. ALLEN
*Deputy Commissioner*
By PORTER LINDER,
*Head of Division.*

1928. 36 * * (Caption 34678) * *

## ANSWER.

Filed Mar 6-1928.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of this taxpayer, admits and denies as follows:

I. The Commissioner for the want of information and knowledge sufficient to form a belief as to the allegations contained in paragraph (I) of the petition neither admits nor denies, but calls for strict proof thereof.

II. Admits the allegations contained in paragraph (II) of the petition.

III. Admits the allegations contained in paragraph (III) of the petition.

IV. Denies the Commissioner erred in respect to the matters set forth in subdivisions (1) and (2) of paragraph (IV) of the petition.

V(a) Admits the allegations contained in subdivision (a) of paragraph (V) of the petition.

V(b) The Commissioner for the want of information and knowledge sufficient to form a belief as to the allegations contained in subdivision (b) of paragraph (V), denies the same.

37 V(c) Admits that at the time of the execution of said trust conveyance on November 29, 1916, said Bristol Mine was subject to a mining lease as alleged in subdivision (c) of paragraph (V), but denies the remainder of the allegations contained in said subdivision (c) of paragraph (V) of the petition.

V(d) Denies the allegations contained in subdivision (d) of paragraph (V) of the petition.

V(e) Denies the allegations contained in subdivision (e) of paragraph (V) of the petition.

V(f) Denies the allegations contained in subdivision (f) of paragraph (V) of the petition.

V(g) Denies the allegations contained in subdivision (g) of paragraph (V) of the petition.

V(h) Denies the allegations contained in subdivision (h) of paragraph (V) of the petition.

V(i) Denies the allegations contained in subdivision (i) of paragraph (V) of the petition.

V(j) Denies the allegations contained in subdivision (j) of paragraph (V) of the petition.

V(k) Denies the allegations contained in subdivision (k) of paragraph (V) of the petition.

V(l) Denies the allegations contained in subdivision (l) of paragraph (V) of the petition.

38 V(m) Admits that the Commissioner disallowed the entire deduction taken by the trustees for depletion in the year 1923, and thereby increased the petitioner's income by the sum of $7,534.97 for the said year 1923, which resulted in the said deficiency in tax of $2,065.93 for the year 1923, as alleged in subdivision (m) of paragraph (V), but denies the remainder of the allegations contained in said subdivision (m) of paragraph (V) of the petition. Further denies that such disallowance was erroneous.

V(n) Denies the allegations contained in subdivision (n) of paragraph (V) of the petition.

V(o) Denies the allegations contained in subdivision (o) of paragraph (V) of the petition.

Denies generally and specifically each and every allegation contained in taxpayer's petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that taxpayer's appeal be denied.

C. M. CHAREST,
*General Counsel, Bureau of Internal Revenue.*

Of Counsel:

SHELBY S. FAULKNER,
*Special Attorney,*
*Bureau of Internal Revenue.*

## AMENDMENT TO ANSWER.

(Read into record July 8, 1932)

* * * The allegations contained in paragraph 1 of the petition are admitted.

4

Ida Lane Smith,
*Petitioner,*
*vs.*
Commissioner of Internal Revenue,
*Respondent.*
} Docket No. 34758.

## DOCKET ENTRIES.

Appearances:

For Taxpayer: Chas. F. Fawsett, Esq., R. S. Doyle, Esq.

For Comm'r.: P. A. Bayer, Esq.

1928

Feb. 8—Petition received and filed. Taxpayer notified. (Fee paid)

Feb. 9—Copy of petition served on General Counsel.

Mar. 28—Answer filed by General Counsel.

Mar. 29—Copy of answer served on taxpayer. General Calendar.

1929

Aug. 30—Notice of the appearance of R. S. Doyle, attorney for taxpayer. See 28070.

1930

Jan. 4—Hearing set Feb. 26, 1930.

Feb. 19—Motion for continuance to April 28, 1930 filed by taxpayer. See 34678. Granted to Feb. 20, 1930.

Apr. 23—Motion for continuance to May 21, 1930 filed by taxpayer. See 28070. April 25, 1930 granted to May 21, 1930.

Apr. 28—Motion to place on field calendar filed by taxpayer. April 30, 1930 granted.

May 21—Hearing set July 8, 1930 at Milwaukee, Wisc.

Jul. 8—Hearing had before S. J. McMahon, Div. 16 on merits. Stipulation of facts received. Consolidated with 34678—35815—34759—40426 and 41089. Briefs due Oct. 1, 1930.

Jul. 25—Transcript of hearing of July 8, 1930, filed.

Sep. 10—Motion for extension to Nov. 1, 1930 to file brief, filed by taxpayer. September 11, 1930 granted.
Oct. 1—Brief filed by General Counsel. See 28075.
Oct. 21—Motion for extension to Dec. 1, 1930 to file brief, filed by taxpayer. October 22, 1930 granted.
Nov. 14—Brief filed by taxpayer.
1931
Oct. 7—Findings of fact and opinion rendered, Stephen J. McMahon, Div. 16. Judgment will be entered for respondent.
Oct. 9—Decision entered, S. J. McMahon, Div. 16.
1932
Feb. 24—Stipulation consolidating Dkts. 28070, 34678, 40426, 34759, 35815 & 41089 for petition for review filed.
Feb. 24—Petition for review by U. S. Circuit Court of Appeals (7) with assignments of error filed by taxpayer.
Feb. 24—Proof of service filed.
Feb. 24—Praecipe filed with proof of service thereon.

39 * * (Caption 34758) * *

## PETITION.

Filed Feb. 8, 1928.

The above named petitioner hereby petitions for redetermination of the proposed deficiency in tax of $7,590.58 against her for the year 1923 set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:FAR:B-2 MLR-60D) dated December 10, 1927, and as a basis for her proceeding alleges as follows:

I. The petitioner is a resident of the city of Milwaukee and a citizen of the state of Wisconsin residing at 411 Terrace Avenue, Milwaukee, Wisconsin, which is also her post office address.

40 II. The notice of deficiency a copy of which is attached and marked Exhibit "A" referred to above is dated December 10, 1927, and was on that date mailed to the petitioner.

III. The taxes in controversy are income and profits taxes claimed to be due from the petitioner for the calendar year 1923 and the amount of such taxes in dispute is the major part of the amount claimed as a deficiency in said notice, to-wit, the sum of $7,590.58, but petitioner is unable to state the precise amount of the tax in controversy based upon the assignment of errors hereinafter stated.

IV. The determination of tax set forth in said notice is based upon the following errors, namely:

(1) The Commissioner erred in disallowing the deduction of $60,279.76 claimed in the return filed by Pfister, Smith and Mariner, Trustees, for the year 1923 as depletion of an iron ore mine which was the subject of the trust referred to in said return and of which trust petitioner was one of the beneficiaries with the result that the sum of $15,069.94 was erroneously added to the taxable income of petitioner
41 for said year 1923 as shown in Exhibit "A" hereto annexed. A copy of the notice of the Commissioner to the said Pfister, Smith and Mariner, Trustees, dated December 10, 1927, disallowing said claimed deduction of $60,279.76 is hereto attached and marked Exhibit "B" and made part hereof.

(2) The Commissioner erred in disallowing depletion claimed for the Gwynn Mine as shown in said Exhibit "A" with the result that $1690.40 was erroneously added to the taxable income of the petitioner.

V. The facts upon which the petitioner relies as a basis of this proceeding are as follows:

(a) In the year 1923 and prior thereto a certain iron ore mine located in the state of Michigan known as the Bristol Mine was held in trust by three trustees which said trust was known as the Pfister, Smith and Mariner Trust.

(b) The provisions of the trust conveyance by which said trust was created in so far as material to this proceeding were in substance as follows:

Said instrument was made, executed and delivered November 29, 1916, by which certain real estate in Michigan
42 including said mine was conveyed to said three trustees in trust with full powers of sale, management and control and providing that after the payment of costs of administration and prior charges,

"All proceeds which shall come to the hands of the trustees from said property or from any use which may be made thereof, or from any source whatsoever hereunder as received by the trustees shall belong to and be the property of the beneficiaries hereunder, to be distributed and paid over to them in proportion to and in accordance with their respective interests as shown herein or as the same shall from time to time appear as hereinafter provided.

The beneficiaries of the trust hereby created and hereinbefore referred to and their respective interests hereunder at

the time of the execution and delivery of this instrument are as follows:

| | |
|---|---|
| Jesse Hoyt Smith— | 1/4 |
| Lucinda W. Mariner— | 1/8 |
| John W. Mariner | 1/8 |
| Charles F. Pfister | 1/8 |
| Louise F. Vogel | 1/8 |
| Executors and trustees under the last will and testament of Jesse Hoyt, deceased— | 1/4." |

On the 4th day of January, 1921, Jesse Hoyt Smith, the owner of a 1/4 beneficial interest under said trust deed as above shown died and this petitioner as the chief beneficiary under his will succeeded to said 1/4th interest, since which time her beneficial interest under said trust and in the net proceeds resulting therefrom has been 1/4th.

43 (c) At the time of the execution of said trust conveyance, to-wit, November 29th, 1916, said Bristol Mine was subject to a mining lease for a term of upwards of 15 years, exceeding the life of said mine on the basis of estimated ore reserves and the established rules for determining the life of said mine, so that during the term of said lease it could be assumed that all of the ore in said mine would be taken out and disposed of under said lease.

(d) The sole income and entire proceeds derived from the trust estate since the execution of said trust conveyance has been the royalties payable by the lessees under said lease to the owners of the fee, who after said trust conveyance were the trustees under said conveyances. The royalty rate reserved in said lease was 19 cents per ton.

(e) In or about the month of February, 1925, in connection with the audit of the accounts of the trustees for the years 1917, 1918, 1919, 1920 and 1921 the basis of valuation of said Bristol Mine for purposes of depletion was revised and redetermined by the mineral section and other repre-

44 sentatives of the Income Tax Unit of the Internal Revenue Department in conference with duly authorized representatives of said trustees with the result that the basis of valuation of said mine for purposes of depletion was determined by the department as follows:

| | | |
|---|---|---|
| Ore reserve 3/1/13 | | 3,556,732 Tons |
| Mined 3/1/13 to 11/29/16 | | |
| 1913 | 379,170 | |
| 1914 | 172,006 | |
| 1915 | 378,830 | |
| 1916 | 462,800 | 1,392,806 |
| Ore reserve 11/29/16 | | 2,163,926 |
| Royalty rate—19 cents | | |
| Gross expected royalty | | $411,146.94 |
| Less 3% expected expense | | 12,334.37 |
| Net expected profit | | 398,811.57 |
| Factor—6%—4%—9 years— .719198 | | |
| None removed from Nov. 29, 1916 to Jan. 1, 1917. | | |
| Value royalties as at Jan. 1, 1917 | | 286,824.48 |

| | | | |
|---|---|---|---|
| Less — 1917 | 188,689 Tons | $25,010.35 | |
| 1918 | 245,280 | 32,511.37 | |
| 1919 | 58,138 | 7,706.07 | |
| 1920 | 368,488 | 48,842.35 | |
| 1921 | 13,555 | 1,796.69 | 115,866.83 |
| | 874,150 | | |
| Residual value—1,289,776 tons at .13255 | | | 170,957.65 |

(f) Said basis of valuation as so determined by the Income Tax Unit was proposed to the representatives of said trustees for acceptance in settlement of the controversy in relation to the matter then pending before said Income Tax Unit and was accepted and expressly agreed to on behalf of said trustees with the understanding that such settlement and determination was subject to the approval of the 45 Commissioner.

(g) Thereafter on March 17, 1925, the trustees received a letter from the Commissioner (IT:PA:3 EPR:301) confirming said determination and basis of valuation for purposes of depletion and advising the trustees of the results of the audit by the Department of their books and accounts for income tax purposes for the years 1917 to 1921 inclusive based on said determination and upon the rates for depletion shown therein.

(h) After the receipt of said letter of March 17, 1925, confirming said settlement and determination of the basis of valuation of said mine for purposes of depletion, the trustees filed returns for the years 1922, 1923 and 1924 on the basis of said determination claiming a deduction of .13255

cents per ton for depletion in accordance therewith and the depletion claimed by them in their said amended return for the year 1923 in accordance with said determination and to which as they are informed and believe, they were lawfully entitled was the sum of $60,279.76.

(i) The facts upon which said rate of depletion was based shown in the statement and computation
46 above referred to, as petitioner is informed and believes, were substantially correct and entitled said trustees to the rate of depletion therein stated, to-wit, .13255 cents per ton.

(j) The ore taken from said mine under said lease for the year 1925 was 454,770 tons which at the rate of depletion established as aforesaid entitled the said trustees to a deduction of $60,279.76.

(k) Since the execution of said trust conveyance it has been the practice of the trustees thereunder as authorized and required by the terms thereof to make distribution of the entire royalties received by them under said lease from time to time among thee bneficiaries of said trust in accordance with their respective interests as before stated after paying or reserving costs of administration and prior charges without reserving from such distribution the portion of such royalties corresponding to the proper allowance for depletion.

(l) In or about the year 1925 the income and profits tax return of petitioner was duly audited by the
47 Department of Internal Revenue for the year 1923 and in determining the taxable income of petitioner for that year derived by her from said trust the deduction of $60,279.76 taken by said trustees for depletion as aforesaid was confirmed, and based thereon an additional tax for said year 1923 was assessed against petitioner which was duly paid by her.

(m) Notwithstanding the foregoing, in the year 1927 the Commissioner undertook to reopen the audit of said return for the year 1923 and upon such reaudit erroneously, as petitioner is advised, disallowed the entire deduction claimed by said trustees for depletion for said year 1923 with the result that $15,069.94 was added to the taxable income of petitioner for the year 1923 and the tax on such additional income is reflected in said notice of deficiency.

(n) With reference to the second assignment of error, the petitioner alleges that prior to the year 1923 and during said year she was the owner of an undivided 3/8ths interest in a certain iron ore mine known as the Gwynn Mine located in

the state of Michigan which was subject to a long term
48 mining lease in the usual form of such leases under which the lessors were entitled to royalty. The other lessors and undivided owners of said mine with their respective interests therein and places of residence were as follows:

Jesse Hoyt Land Company, City of New York..... 3/8
Susan Powell, city of Marquette, Michigan..... 1/8
Charles Cummings, City of Marquette, Michigan..... 1/16
William C. Webber, City of Detroit, Michigan..... 1/16

Petitioner was entitled in the year 1923 to a rate of depletion on her said 3/8th interest in said mine fairly computed in an amount of not less than .5923 per ton. In said year 1923 there was shipped from said mine 28,539 tons of ore which entitled the petitioner to a depletion shown for said year in an amount not less than the sum of $1,690.40. Nevertheless the Commissioner upon an audit or reaudit of the said return of this petitioner for the year 1923 wholly disallowed the deduction of $1,690.40 claimed by petitioner for depletion on account of her interest in said Gwynn Mine thereby adding to the taxable income of petitioner for said year 1923 said sum of $1,690.40 the tax on which additional income is reflected in said tax liability of $7,590.58 shown in said notice of deficiency.

49 (o) Petitioner alleges upon information and belief that said sums of $15,069.94 add $1,690.41 added to the taxable income of petitioner for the year 1923 were not in law or in fact income but represented to that extent a return to the petitioner of her share of the corpus of said Bristol and Gwynn Mines covered by said mining leases and that such additions to the taxable income of petitioner were erroneous.

(p) Petitioner further alleges upon information and belief that by reason of the facts hereinbefore stated the reopening of the audit of the income and profits tax return of petitioner for the year 1923 in the year 1927 was erroneous and without justification.

Wherefore petitioner prays that this Board hear this proceeding; that the deduction for depletion taken by said trustees for the year 1923 for said Bristol Mine be affirmed and allowed, and that the deduction in her return for the year 1923 on account of her interest in said Gwynn Mine be allowed, and that the tax liability of the petitioner, if any, be determined accordingly and in accordance with the facts hereinbefore stated.

CHARLES F. FAWSETT
*Counsel for Petitioner.*

P. O. Address: 420 East Water St.
Milwaukee, Wis.

50 State of California,
County of Los Angeles. } ss.

IDA LANE SMITH being first duly sworn says she is the petitioner making the foregoing petition; that she has read said petition and is familiar with the contents thereof and that the same is true of her own knowledge except as to matters therein stated to be on information and belief and as to those matters she believes it to be true.

IDA LANE SMITH

Subscribed and sworn to before me this 2nd day of February, 1928.

VERNA C. CHURCHILL
(Seal) *Notary Public, Los Angeles County, California.*

51 EXHIBIT "A".

TREASURY DEPARTMENT
Washington

Dec. 10, 1927.

IT:FAR:B-2
MLR-60D
Mrs. Ida Lane Smith,
411 Terrace Avenue,
Milwaukee, Wisconsin.

Madam:

The determination of your income tax liability for the year 1923 discloses a deficiency in tax amounting to $7,590.58 as shown in the attached statement.

In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collec-

tor of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the enclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:FAR:B-2-MLR-60D. In the event that you acquiesce in a part of the determination the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR,
*Commissioner.*
By C. B. ALLEN,
*Deputy Commissioner.*

Enclosures
Statement
Form A
Form 882

52 Statement.

IT:FAR:B-2
MLR-60D

*In re:* Mrs. Ida Lane Smith
411 Terrace Avenue,
Milwaukee, Wisconsin.

Dec. 10, 1927.

| Year | Deficiency |
|---|---|
| 1923 | $7,590.58 |

| | | |
|---|---|---|
| Changes in income: | | |
| Total net income reported in your return | | $46,693.26 |
| Additions: | | |
| (1) Adjustment in Trust Income Pfister, Smith and Mariner, Trustees Reported by Revenue Agent | $17,064.22 | |
| Corrected | | 32,134.16 |
| (2) Depletion, Gwynn Mine disallowed | | 1,690.40 |
| (3) Legal expense disallowed | | 554.34 |
| Deduct | | 81,072.16 |
| (4) Capital Net Gain Transferred from ordinary income | | 8,252.05 |
| Ordinary income as adjusted for tax | | $72,820.11 |

Explanation of Changes:

(1) Income from Pfister, Smith and Mariner has been increased from $17,064.22, the amount shown by the Examining officer, to $32,134.16 for the reason that depletion claimed by the trustees has been disallowed as a deduction in the Fiduciary return. This adjustment has been fully explained in a separate communication addressed to the trustees.

(2) Information on file in this office does not indicate that the 3/8 fee interest in the Gwynn mine has ever been assigned to you. The depletion has, therefore, been disallowed. In any event it appears that you would not be entitled to depletion based on the March 1, 1915 value as claimed.

53 (3) Legal expenses in the amount of $554.34 paid in connection with land in Northern Wisconsin has been disallowed for the reason that same is held to be a capital expense.

(4) Profit on sale of property acquired by inheritance in January 1921 has been transferred from ordinary income to capital net gain and the tax computed thereon at 12½% as provided by Section 206 of the Revenue Act of 1921.

Payment should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

54 EXHIBIT "B".

TREASURY DEPARTMENT
Washington

IT:FAR:B-2
MLR

Dec. 10, 1927.

Pfister, Smith and Mariner, Trustees,
133 Mason Street,
Milwaukee, Wisconsin.

Sirs:

A review of your 1923 return of income, Form 1041, has been completed in connection with an examination of your books of account and records.

The report of the Internal Revenue Agent in Charge at Milwaukee, Wisconsin, dated November 28, 1925, has been reviewed and approved for 1923 with the following exception:

It is found that depletion is not deductible from the distributive income of the trust since the terms of the trust agreement do not appear to meet the requirements outlined in Treasury Decision 2267, ARR 3959 (Cumulative Bulletin

II-2, Page 162), and IT:2218 (Cumulative Bulletin III-2, page 61).

The amount of $60,279.76 deducted for depletion is therefore added to the net income reported in the amended Form 1041, resulting in a revised distributive income of $128,536.66 which will be apportioned among the beneficiaries as follows:

| | |
|---|---|
| Chas. F. Pfister | $16,067.08 |
| Elmwood Company of Delaware | 16,067.08 |
| Ida Lane Smith | 32,134.16 |
| J. W. Mariner | 32,134.16 |
| A. M. Hoyt and Company | 25,707.34 |
| Alice C. Dane | 6,426.84 |

The beneficiaries will be duly notified of the adjustment in their individual income.

Respectfully,
C. B. ALLEN
*Deputy Commissioner.*
By PORTER LINDER
*Head of Division.*

1928. 55 * * (Caption 34758) * *

## ANSWER.

Filed Mar. 28, 1928.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of this taxpayer, admits and denies as follows:

I. Admits the allegations contained in paragraph (I) of the petition.

II. Admits the allegations in paragraph (II) of the petition.

III. Admits the allegations contained in paragraph (III) of the petition.

IV. Denies the Commissioner erred in respect to the matters set forth in subdivisions (1) and (2) of paragraph (IV) of the petition.

V(a). Admits the allegations contained in subdivision (a) of paragraph (V) of the petition.

V(b) The Respondent for the want of information or knowledge sufficient to form a belief as to the remainder of the allegations contained in subdivision (b) of paragraph (V), denies the same.

V(c). Admits that at the time of the execution of said trust conveyance on November 29, 1916, said Bristol Mine
56 was subject to a mining lease, but denies the remainder of the allegations contained in subdivision (c) of paragraph (V) of the petition.

V(d). Denies the allegations contained in subdivision (d) of paragraph )V) of the petition.

V(e). Denies the allegations contained in subdivision (e) of paragraph (V) of the petition.

V(f) Denies the allegations contained in subdivision (f) of paragraph (V) of the petition.

V(g). Denies the allegations contained in subdivision (g) of paragraph (V) of the petition.

V(h). Denies the allegations contained in subdivision (h) of paragraph (V) of the petition.

V(i). Denies the allegations contained in subdivision (i) of paragraph (V) of the petition.

V(j). Denies the allegations contained in subdivision (j) of paragraph (V) of the petition.

V(k). Denies the allegations contained in subdivision (k) of paragraph (V) of the petition.

V(l). Denies the allegations contained in subdivision (l) of paragraph (V) of the petition.

V(m). Admits that the Commissioner disallowed the entire deduction taken by the trustees for depletion in the
57 year 1923, but denies the remainder of the allegations contained in subdivision (m) of paragraph (V) of the petition. Further denies that such disallowance was erroneous.

V(n). Admits the Commissioner disallowed the sum of $1,690.40 as a deduction from gross income for the year 1923, representing alleged depletion taken on the Gwynn Mine, and increased taxable income for 1923 by the said sum of $1,690.40, but denies the remainder of the allegations contained in subdivision (n) of paragraph (V) of the petition.

Specifically denies that any interest in the said Gwynn Mine was ever assigned to the petitioner.

V(o). Denies the allegations contained in subdivision (o) of paragraph (V) of the petition.

V(p). Denies the allegations contained in subdivision (p) of paragraph (V) of the petition.

Denies generally and specifically each and every allegation contained in taxpayer's petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that taxpayer's appeal be denied.

(Signed) C. M. CHAREST
C. M. Charest,
*General Counsel, Bureau of Internal Revenue.*

Of Counsel:
SHELBY S. FAULKNER,
*Special Attorney, Bureau of Internal Revenue.*

5

J. W. Mariner,
*Petitioner,*
*vs.*
Commissioner of Internal Revenue,
*Respondent.*
} Docket No. 34759.

Appearances:

For Taxpayer: Chas. F. Fawsett, Esq., R. S. Doyle, Esq.

For Comm'r.: P. A. Bayer, Esq.

DOCKET ENTRIES.

1928

Feb. 8—Petition received and filed. Taxpayer notified. (Fee paid)

Feb. 9—Copy of petition served on General Counsel.

Mar. 28—Answer filed by General Counsel.

Mar. 29—Copy of answer served on taxpayer. General Calendar.

1929

Aug. 30—Notice of the appearance of R. S. Doyle, attorney for taxpayer. See 28070.

1930

Jan. 4—Hearing set February 26, 1930.

Feb. 19—Motion to continue to April 28, 1930, filed by taxpayer. See 34678. February 20, 1930 granted.

Apr. 23—Motion to continue to May 21, 1930 filed by taxpayer. See 28070. April 25, 1930 granted to May 21, 1930.

Apr. 28—Motion to place on Field Calendar filed by taxpayer. April 30, 1930 granted.

May 21—Hearing set July 8, 1930 at Milwaukee, Wisc.

Jul. 8—Hearing held before Stephen J. McMahon, Div. 16 on merits. Stipulation of facts received. Consolidated with 34678, 35815, 34758, 40426 and 41089. Briefs due Oct. 1, 1930.

July 25—Transcript of hearing of July 8, 1930, filed.
Sep. 10—Motion for extension to Nov. 1, 1930 to file brief, filed by taxpayer. September 11, 1930 granted.
Oct. 1—Brief filed by General Counsel. See 28070.
Oct. 21—Motion for extension to December 1, 1930 to file brief, filed by taxpayer. October 22, 1930 granted.
Nov. 14—Brief filed by taxpayer.

1931

Oct. 7—Findings of fact and opinion rendered, S. J. McMahon, Div. 16. Judgment will be entered for respondent.
Oct. 9—Decision entered, S. J. McMahon, Div. 16.

1932

Feb. 24—Stipulation consolidating dockets 28070, 34678, 34758, 34759, 35815, 40426 and 41089 for petition for review, filed.
Feb. 24—Petition for review by U. S. Circuit Court of Appeals (7) with assignments of error, filed by taxpayer.
Feb. 24—Proof of service filed.
Feb. 24—Praecipe filed with proof of service thereon.

58 * * (Caption 34759) * *

## PETITION.

Filed Feb. 8, 1928.

The above named petitioner hereby petitions for redetermination of the proposed deficiency in tax of $6,281.54 against him for the year 1923 set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:FAR:B-2, MLR-60D) dated December 19, 1927, and as a basis of his proceeding alleges as follows:

I. The petitioner is a resident of the city of Milwaukee and a citizen of the state of Wisconsin. His post office address is 133 Mason Street, Milwaukee, Wisconsin.

59 II. The notice of deficiency, a copy of which is attached and marked Exhibit "A" referred to above, is dated December 10, 1927, and was on that date mailed to the petition at his said post office address.

III. The taxes in controversy are income and profits taxes claimed to be due from the petitioner for the calendar year 1923 and the amount of such taxes in dispute is so much of said sum of $6,281.54 as resulted from the addition of $27,113.63 to the taxable income of the petitioner as the re-

sult of the adjustment of income from Pfister, Smith and Mariner, Trustees, shown in the acompanying statement which is a part of said Exhibit "A", and from the disallowance of the item "Loss on Stock" amounting to $4,875.00 shown in said statement.

IV. The determination of tax set forth in said notice is based upon the following errors:

(1) The Commissioner erred in disallowing the deduction of $60,279.76 claimed in the return filed by Pfister, Smith and Mariner, Trustees, for the year 1923 as depletion of an iron ore mine which was the subject of the trust referred
60 to in said return, and of which trust the petitioner was one of the beneficiaries, with the result that the sum of $27,113.63 was erroneously added to the taxable income of petitioner for said year 1923. A copy of the notice of the Commissioner to the said Pfister, Smith and Mariner, Trustees, dated December 10, 1927, disallowing said claimed deduction of $60,279.76 is attached hereto, marked Exhibit "B" and made part hereof.

(2) The Commissioner erred in refusing to allow as a deduction from the petitioner's taxable income for the year 1923 the sum of $4,875.00, "Loss on Stock" referred to in Exhibit "A" hereto annexed.

V. The facts upon which petitioner relies as the basis for this proceeding are as follows:

(a) In the year 1923 and prior thereto a certain iron ore mine located in the state of Michigan known as the Bristol Mine was held in trust by the petitioner and two other trustees under which the petitioner was one of the beneficiaries.

(b) The provisions of the trust conveyance by which said trust was created in so far as material to this proceeding were in substance as follows:
61 Said instrument was made, executed and delivered November 29, 1916, by which certain real estate in Michigan including said mine was conveyed to the trustees of which the said petitioner was one, in trust, with full powers of sale, management and control and providing that after the payment of costs of administration and prior charges,

"All proceeds which shall come to the hands of the trustees from said property or from any use which may be made thereof, or from any source whatsoever hereunder as received by the trustees shall belong to and be the property of the beneficiaries hereunder, to be distributed and paid over to them in proportion to and in accordance with their re-

spective interests as shown herein or as the same shall from time to time appear as hereinafter provided.

The beneficiaries of the trust hereby created and hereinbefore referred to and their respective interests hereunder at the time of the execution and delivery of this instrument are as follows:

| | |
|---|---|
| Jesse Hoyt Smith | |
| Lucinda W. Mariner | 1/4 |
| John W. Mariner | 1/8 |
| Charles F. Pfister | 1/8 |
| Louise F. Vogel | 1/8 |
| Executors and trustees under the last will and testament of Jesse Hoyt, deceased, | 1/8 |
| | 1/4." |

Prior to the year 1923 the above named Lucinda W. Mariner died, and the petitioner succeeded to her 1/8th
62 interest under said trust since which time and during the year 1923 his beneficial interest under said trust was 1/4th.

(c) At the time of the execution of said trust conveyance, to-wit, November 29, 1916, said Bristol Mine was subject to a mining lease for a term of upwards of 15 years, exceeding the life of said mine on the basis of estimated ore reserves and the established rules for determining the life of said mine, so that during the term of said lease it could be assumed that all of the ore in said mine would be taken out and disposed of under said lease.

(d) The sole income and entire proceeds derived from the trust estate since the execution of said trust conveyance has been the royalties payable by the lessees under said lease to the owners of the fee, who after said trust conveyance were the trustees under said conveyance. The royalty rate reserved in said lease was 19 cents per ton.

(e) In or about the month of February, 1925, in connection with the audit of the accounts of the trustees for the years 1917, 1918, 1919, 1920 and 1921 the basis of valua-
63 tion of said Bristol Mine for purposes of depletion was revised and redetermined by the mineral section and other representatives of the Income Tax Unit of the Internal Revenue Department in conference with duly authorized representatives of said trustees with the result that the basis of valuation of said mine for purposes of depletion was determined by the department as follows:

| | | | |
|---|---|---|---|
| Ore reserve 3/1/13 | | | 3,556,732 Tons |
| Mined 3/1/13 to 11/29/16 | | | |
| 1913 | 379,170 | | |
| 1914 | 172,006 | | |
| 1915 | 378,830 | | |
| 1916 | 462,800 | | 1,392,806 |
| Ore reserve 11/29/16 | | | 2,163,926 |
| Royalty rate—19 cents | | | |
| Gross expected royalty | | | $411,146.94 |
| Less 3% expected expense | | | 12,334.37 |
| Net expected profit | | | 398,811.57 |
| Factor—6%—4%—9 years—.719198 | | | |
| None removed from Nov. 29, 1916 to Jan. 1, 1917 | | | |
| Value royalties as at Jan. 1, 1917 | | | 286,824.48 |
| Less—1917 | 188,689 Tons | $ 25,010.35 | |
| 1918 | 245,280 | 32,511.37 | |
| 1919 | 58,138 | 7,706.07 | |
| 1920 | 368,488 | 48,842.35 | |
| 1921 | 13,555 | 1,796.69 | 115,866.83 |
| | 874,150 | | |
| Residual value—1,289,776 tons at .13255 | | | 170,957.65 |

(f) Said basis of valuation as so determined by the Income Tax Unit was proposed to the representatives of said trustees for acceptance in settlement of the controversy in relation to the matter then pending before said Income
64 Tax Unit and was accepted and expressly agreed to on behalf of said trustees with the understanding that such settlement and determination was subject to the approval of the Commissioner.

(g) Thereafter on March 17, 1925, the trustees received a letter from the Commissioner (IT:PA:3 EPR:301) confirming said determination and basis of valuation for purposes of depletion and advising the trustees of the results of the audit by the Department of their books and accounts for income tax purposes for the years 1917 to 1921 inclusive based on said determination and upon the rates for depletion shown therein.

(h) After the receipt of said letter of March 17, 1925, confirming said settlement and determination of the basis of valuation of said mine for purposes of depletion, the trustees filed returns for the years 1922, 1923 and 1924 on the basis

of said determination claiming a deduction of .13255 cents per ton for depletion in accordance therewith and the depletion claimed by them in their said amended return for the year 1923 in accordance with said determination and to which as they are informed and believe, they were lawfully entitled was the sum of $60,279.76.

65 (i) The facts upon which said rate of depletion was based shown in the statement and computation above referred to, as petitioner is informed and believes, were substantially correct and entitled said trustees to the rate of depletion therein stated, to-wit, .13255 cents per ton.

(j) The ore taken from said mine under said lease for the year 1923 was 454,770 tons which at the rate of depletion established as aforesaid entitled the said trustees to a deduction of $60,279.76.

(k) Since the execution of said trust conveyance it has been the practice of the trustees thereunder as authorized and required by the terms thereof to make distribution of the entire royalties received by them under said lease from time to time among the beneficiaries of said trust in accordance with their respective interests as before stated after paying or reserving costs of administration and prior charges without reserving from such distribution the portion of such royalties corresponding to the proper allowance for depletion.

(l) In the year 1925 the income and profits tax return of petitioner for the year 1923 was duly audited

66 by the Department of Internal Revenue and in determining the taxable income of petitioner for that year derived by him from said trust, the deduction of $60,279.76 taken by said trustees for depletion as aforesaid was accepted and confirmed by the Commissioner and based thereon the income derived by petitioner from said trust for the year 1923 was adjusted at the sum of $17,064.22 which adjustment is accepted by petitioner and the additional assessment based on said audit of his said return for the year 1923 is ready to be paid on demand.

(m) Notwithstanding the foregoing, in the year 1927 the Commissioner undertook to reopen the audit of said return of petitioner for the year 1923 and upon such reaudit erroneously disallowed the entire deduction claimed by said trustees for depletion for said year 1923 with the result that $5,1069.94 was added to the taxable income of petitioner for the year 1923 and the tax thereon is reflected in said claimed deficiency tax of $6,281.54 shown in said notice of deficiency.

(n) Petitioner alleges upon information and belief that said sum of $15,069.94 added to the taxable income of petitioner for the year 1923 as aforesaid was not in law
67 or in fact income but represented to that extent a return to the petitioner of his share of the corpus of the trust estate held by said trustees and that such addition to his taxable income was erroneous.

(o) Petitioner further alleges upon information and belief that by reason of the facts hereinbefore stated the determination of the valuation of said mine for purposes of depletion and the depletion rate as aforesaid and the audit of the return of petitioner for 1923 made in the year 1925 and the readiness to make payment of the additional assessment based on said audit as aforesaid should be held to be binding and conclusive upon the Commissioner, and that the reopening of said audit in the year 1927 was erroneous and without justification.

(p) With reference to the assignment of error numbered (2), the petitioner alleges that said item of $4,875.00 disallowed as shown in the statement attached to said Exhibit "A" represented an investment of that amount in the stock of the Grant Marble Company, a Wisconsin corporation, sometime prior to the year 1923. In the year 1923 upon inquiry the petitioner learned that said stock was worthless
68 and caused the same to be charged off on his books accordingly. Said investment was made for profit as a business transaction and turned out to be an actual and total loss ascertained to be such by petitioner in the year 1923 and the disallowance thereof by the Commissioner is claimed to be error.

Wherefore petitioner prays that this Board hear this proceeding; that the deduction for depletion taken by said trustees for the year 1923 be affirmed and allowed and that the tax liability of petitioner for said year be redetermined accordingly; that said item of $4,875.00 erroneously disallowed by the Commissioner be allowed the petitioner as a loss in the year 1923 and that the tax liability of the petitioner, if any, be determined in accordance with the facts hereinbefore stated.

CHARLES F. FAWSETT,
*Counsel for Petitioner*

P. O. Address: 425 East Water Street,
Milwaukee, Wisconsin.

69 State of California, }
County of Los Angeles. } ss.

J. W. MARINER being first duly sworn says he is the petitioner making the foregoing petition; that he has read said petition and is familiar with the contents thereof and that the same is true of his own knowledge except as to matters therein stated to be on information and belief and as to those matters he believes it to be true.

JOHN W. MARINER.

Subscribed and sworn to before me this 2nd day of February, 1928.

(Seal) JOSEPH REED,
*Notary Pubilc, Los Angeles County, California.*

My commission expires June 30, 1928.

70 EXHIBIT "A".

TREASURY DEPARTMENT
Washington

IT:FAR:B-2-60D
MLR

Dec. 10, 1927.

Mr. J. W. Mariner,
133 Mason Street,
Milwaukee, Wisconsin.

Sir:

The determination of your income tax liability for the taxable year 1923, discloses a deficiency in tax amounting to $6,281.54, for the year 1923, as shown in the attached statement.

In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition

and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the enclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C. for the attention of IT:FAR:B-2-60D-MLR.

In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,
D. H. BLAIR,
*Commissioner,*
By C. B. ALLEN,
*Deputy Commissioner.*

Enclosures:
Statement
Form A

71 IT:FAR:B-2-60D
MLR

Statement.

Dec. 10, 1927.

*In re*: Mr. J. W. Mariner,
133 Mason Street,
Milwaukee, Wisconsin.

| Year | Deficiency |
|---|---|
| 1923 | $6,281.54 |

The report of the Internal Revenue Agent in Charge at Milwaukee, Wisconsin, dated December 1, 1925, has been reviewed and your taxable net income has been adjusted as follows:

| | | |
|---|---|---|
| Total net income reported in your return | | $16,724.32 |
| Add: | | |
| 1. Adjustment of income from Pfister, Smith and Mariner— | | |
| Reported | $ 5,020.43 | |
| Corrected | 32,134.16 | 27,113.63 |

| | | |
|---|---|---|
| Deductions disallowed— | | |
| 2. Loss on stock | 4,875.00 | |
| 3. Annuity paid to sister-in-law | 4,000.00 | |
| 4. Amount paid to Mrs. Brooks | 1,212.50 | |
| 5. Lawyers fees | 35.00 | 37,236.13 |
| Total | | $53,960.45 |
| Deduct: | | |
| 6. Adjustment for contributions: | | |
| Claimed | 2,951.34 | |
| Allowable | 2,975.00 | 23.66 |
| | | 53,936.79 |

72 Explanation of Changes.

1. Income from Pfister, Smith and Mariner, has been increased from $5,020.43 to $32,134.16, instead of $17,064.22, as shown by the examining officer. This is due to the fact that depletion claimed on Form 1041 has been disallowed as a deduction on the fiduciary return. This adjustment has been fully explained in a separate communication addressed to Pfister, Smith and Mariner.

2. The loss of $4,875.00 on stock of the Grant Marble Company has been disallowed for the reason that this stock was determined worthless prior to 1923.

3. The annuity of $4,000.00 paid to your sister-in-law for her interest in her husband's estate does not constitute an allowable deduction for income tax purposes.

4. The amount of $1,212.50 paid to Mr. Brooks in connection with an Inheritance tax report for the Estate of your Mother, Lucinda W. Mariner, is not an allowable deduction, on the return of a beneficiary. If such a deduction were allowable for income tax purposes it would be necessary that the same be claimed on the return filed for the estate. Inasmuch as you state that the amount was paid by you after the estate was closed and at a time when the Government sought to collect further tax by increasing the valuations placed on the estate property, it appears that the expenditure thus became a capital item in the nature of an amount paid for protecting your interests in the estate and would serve to reduce your share of the corpus.

5. The lawyer's fee of $35.00 for making your Will is purely a personal expense and the deduction is accordingly disallowed.

6. Inasmuch as your income has been increased by $37,236.13, as the result of the foregoing adjustments, contribu-

tions originally limited by you to 15% of your taxable net income have been allowed in the full amount of $2,975.00.

Payment should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

73 EXHIBIT "B".

TREASURY DEPARTMENT.
Washington

Dec. 10, 1927.

IT:FAR:B-2
MLR
Pfister, Smith and Mariner, Trustees,
133 Mason Street,
Milwaukee, Wisconsin.

Sirs:

A review of your 1923 return of income, Form 1041, has been completed in connection with an examination of your books of account and records.

The report of the Internal Revenue Agent in Charge at Milwaukee, Wisconsin, dated November 28, 1925, has been reviewed and approved for 1923 with the following exception:

It is found that depletion is not deductible from the distributive income of the trust since the terms of the trust agreement do not appear to meet the requirements outlined in Treasury Decision 2267, ARR 3959 (Cumulative Bulletin II-2, Page 162), and IT:2218 (Cumulative Bulletin III-2, page 61).

The amount of $60,279.76 deducted for depletion is therefore added to the net income reported in the amended Form 1041, resulting in a revised distributive income of $128,536.66 which will be apportioned among the beneficiaries as follows:

| | |
|---|---|
| Chas. F. Pfister | $16,067.08 |
| Elmwood Company of Delaware | 16,067.08 |
| Ida Lane Smith | 32,134.16 |
| J. W. Mariner | 32,134.16 |
| A. M. Hoyt and Company | 25,707.34 |
| Alice C. Dane | 6,426.84 |

The beneficiaries will be duly notified of the adjustment in their individual income.

Respectfully,
C. B. ALLEN,
*Deputy Commissioner,*
By PORTER LINDER,
*Head of Division.*

74 * * (Caption 34759) * *

## ANSWER.

Filed Mar. 28, 1928.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of this taxpayer, admits and denies as follows:

I. Admits the allegations contained in paragraph (I) of the petition.

II. Admits the allegations contained in paragraph (II) of the petition.

III. Admits the allegations contained in paragraph (III) of the petition.

IV. Denies the Commissioner erred in respect to the matters set forth in subdivisions (1) and (2) of paragraph (IV) of the petition.

V(a). Admits the allegations contained in subdivision (a) of paragraph (V) of the petition.

V(b). The Respondent for the want of information and knowledge sufficient to form a belief as to the allegations contained in subdivision (b) of paragraph (V), denies the same.

75 V(c). Admits that at the time of the execution of said trust conveyance on November 29, 1916, said Bristol Mine was subject to a mining lease, but denies the remainder of the allegations contained in said subdivision (c) of paragraph (V) of the petition.

V(d). Denies the allegations contained in subdivision (d) of paragraph (V) of the petition.

V(e). Denies the allegations contained in subdivision (e) of paragraph (V) of the petition.

V(f). Denies the allegations contained in subdivision (f) of paragraph (V) of the petition.

V(g). Denies the allegations contained in subdivision (g) of paragraph (V) of the petition.

V(h). Denies the allegations contained in subdivision (h) of paragraph (V) of the petition.

V(i). Denies the allegations contained in subdivision (i) of paragraph (V) of the petition.

V(j). Denies the allegations contained in subdivision (j) of paragraph (V) of the petition.

V(k). Denies the allegations contained in subdivision (k) of paragraph (V) of the petition.

V(l). Denies the allegations contained in subdivision (l) of paragraph (V) of the petition.

V(m). Admits that the Commissioner disallowed the entire deduction taken by the trustees for depletion in the
76 year 1923, but denies the remainder of the allegations contained in subdivision (m) of paragraph (V) of the petition. Further denies that such disallowance was erroneous.

V(n). Denies the allegations contained in subdivision (n) of paragraph (V) of the petition.

V(o). Denies the allegations contained in subdivision (o) of paragraph (V) of the petition.

V(p). Denies the allegations contained in subdivision (p) of paragraph (V) of the petition.

Denies generally and specifically each and every allegation contained in taxpayer's petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that taxpayer's appeal be denied.

(Signed) C. M. CHAREST,
C. M. Charest,
*General Counsel, Bureau of Internal Revenue.*

Of Counsel:
SHELBY S. FAULKNER,
*Special Attorney, Bureau of Internal Revenue.*

6 The Elmwood Company of Delaware, *Petitioner,* vs. Commissioner of Internal Revenue, *Respondent.* } Docket No. 35815.

Appearances:

For Taxpayer: Chas. F. Fawsett, Esq., R. S. Doyle, Esq.

For Comm'r.: P. A. Bayer, Esq.

DOCKET ENTRIES.

1928

Feb. 27—Petition received and filed. Taxpayer notified. (Fee paid).

Feb. 28—Copy of petition served on General Counsel.
Apr. 16—Answer filed by General Counsel.
Apr. 17—Copy of answer served on taxpayer. General Calendar.

1929

Aug. 30—Notice of appearance of R. S. Doyle as counsel for taxpayer filed.

1930

Jan. 4—Hearing set Feb. 26, 1930.
Feb. 19—Motion for continuance to April 28, 1930 filed by taxpayer. (34678).
Feb. 20—Motion granted and set for hearing on April 28, 1930.
Apr. 23—Motion to continue to May 21, 1930 filed by taxpayer. See 28070. April 25, 1930 granted to May 21, 1930.
Apr. 28—Motion to transfer to the Milwaukee, Wisc. Circuit Calendar, filed by taxpayer.
Apr. 30—Motion granted.
May 21—Hearing set July 8, 1930, Milwaukee, Wisc.
Jul. 8—Hearing had before Stephen J. McMahon, Div. 16 on merits. For record of exhibits set docket 28070. Stipulation of facts received. Consolidated for hearing and decision with dockets 28070, 34678, 34758, 34759, 40426 and 41089. Briefs due Oct. 1, 1930.
Jul. 25—Transcript of hearing of July 8, 1930, filed.
Sep. 10—Motion for extension to Nov. 1, 1930 to file brief, filed by taxpayer. Sept. 11, 1930 granted.
Oct. 1—Brief filed by General Counsel.
Oct. 21—Motion for extension to Dec. 1, 1930 to file brief, filed by taxpayer. Oct. 22, 1930 granted.
Nov. 14—Brief filed by taxpayer.

1931

Oct. 7—Findings of fact and opinion rendered. Stephen J. McMahon, Div. 16. Judgment will be entered for the respondent.
Oct. 9—Decision entered, Stephen J. McMahon, Div. 16.

1932

Feb. 24—Stipulation to consolidate with dockets 28070, 34678, 34758, 34759, 40426 and 41089 for the purpose for review, filed.
Feb. 24—Petition for review to U. S. Circuit Court of Appeals (7) with assignments of error, filed by taxpayer.
Feb. 24—Proofs of service filed.
Feb. 24—Praecipe with proof of service thereon filed.

1928. 77 * * (Caption 35815) * *

PETITION.

Filed Feb. 27, 1928.

The above named petitioner hereby petitions for redetermination of the proposed deficiency in tax of $941.27 against the petitioner for the year 1923 as set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:FAR:A6 EIM:60D) dated January 7, 1928 and as a basis of its proceeding alleges as follows:

I.

The above named petitioner is a corporation duly organized and existing under the laws of Delaware.

78 II.

The notice of deficiency a copy of which is attached marked Exhibit "A" referred to above is dated and was mailed to the petitioner January 7, 1928.

III.

The taxes in controversy are income and profits taxes claimed to be due from the petitioner for the calendar year 1923 and the amount of such taxes in dispute is the entire amount claimed as a deficiency in said notice, to-wit, the sum of $941.27.

IV.

The determination of said tax set forth in said notice is based upon the following errors, namely:

(1) The Commissioner erred in disallowing the deduction of $60,279.76 claimed in the return filed by Pfister, Smith and Mariner, Trustees, for the year 1923 as depletion of an iron ore mine which was the subject of the trust referred to in said return with the result that one-eighth of said amount,
79 being the beneficial interest of the petitioner under said trust was erroneously added to the taxable income of the petitioner for the year 1923 as shown by said Exhibit "A" hereto annexed. A copy of the notice of the Commissioner to the said Pfister, Smith and Mariner, Trustees, dated December 10, 1927, disallowing said claimed deduction of $60,279.76 is hereto attached marked Exhibit "B" and made part thereof.

(2) The Commissioner erred in determining that there is any deficiency in tax due from petitioner for the year 1923.

V.

The facts upon which petitioner relies as the basis of its proceeding are as follows:

(a) In the year 1923 and prior thereto a certain iron ore mine located in the state of Michigan known as the Bristol Mine was held in trust by three trustees.

(b) The provisions of the trust conveyance by which said trust was created in so far as material to this proceeding were in substance as follows:

80 Said instrument was made, executed and delivered November 29, 1916, by which certain real estate in Michigan including said mine was conveyed to the trustees above referred to or their predecessors in trust with full powers of sale, management and control and providing that after the payment of the costs of administration and prior charges:

"All proceeds which shall come to the hands of the trustees from said property or from any use which may be made thereof, or from any source whatsoever hereunder as received by the trustees shall belong to and be the property of the beneficiaries hereunder, to be distributed and paid over to them in proportion to and in accordance with their respective interests as shown herein or as the same shall from time to time appear as hereinafter provided.

The beneficiaries of the trust hereby created and hereinbefore referred to and their respective interests hereunder at the time of the execution and delivery of this instrument are as follows:

| | |
|---|---|
| Jesse Hoyt Smith — | 1/4 |
| Lucinda W. Mariner— | 1/8 |
| John W. Mariner— | 1/8 |
| Charles F. Pfister— | 1/8 |
| Louise F. Vogel— | 1/8 |
| Executors and trustees under the last will and testament of Jesse Hoyt, deceased— | 1/4." |

The petitioner has succeeded to and was in the year 1923 and is now the owner of the 1/8th interest of Louise F. Vogel referred to above.

(c) At the time of the execution of said trust conveyance, to-wit, November 29th, 1916, said Bristol Mine was sub-
81 ject to a mining lease for a term of upwards of 15 years, exceeding the life of said mine on the basis of estimated

ore reserves and the established rules for determining the life of said mine, so that during the term of said lease it could be assumed that all of the ore in said mine would be taken out and disposed of under said lease.

(d) The sole income and entire proceeds derived from the trust estate since the execution of said trust conveyance has been the royalties payable by the lessees under said lease to the owners of the fee, who after said trust conveyance were the trustees under said conveyance. The Royalty rate reserved in said lease was 19 cents per ton.

(e) In or about the month of February, 1925, in connection with the audit of the accounts of the trustees for the years 1917, 1918, 1919, 1920 and 1921 the basis of valuation of said Bristol Mine for purposes of depletion was revised and redetermined by the mineral section and other representatives of the Income Tax Unit of the Internal Revenue Department in conference with duly authorized representa-
82 tives of said trustees with the result that the basis of valuation of said mine for purposes of depletion was determined by the department as follows:

| | | | |
|---|---|---|---|
| Ore reserve 3/1/13 | | | 3,556,732 Tons |
| Mined 3/1/13 to 11/29/16 | | | |
| 1913 | 379,170 | | |
| 1914 | 172,006 | | |
| 1915 | 378,830 | | |
| 1916 | 462,800 | | 1,392,806 |
| Ore reserve 11/29/16 | | | 2,163,926 |
| Royalty rate—19 cents | | | |
| Gross expected royalty | | | $411,146.94 |
| Less 3% expected expense | | | 12,334.37 |
| Net expected profit | | | 398,811.57 |
| Factor—6%—4%—9 years—.719198 | | | |
| None removed from Nov. 29, 1916 to Jan. 1, 1917 | | | |
| Value royalties as at Jan. 1, 1917 | | | 286,824.48 |
| Less—1917 | 188,689 Tons | $25,010.35 | |
| 1918 | 245,280 | 32,511.37 | |
| 1919 | 58,138 | 7,706.07 | |
| 1920 | 368,488 | 48,842.35 | |
| 1921 | 13,555 | 1,796.69 | 115,866.83 |
| | 874,150 | | |
| Residual value—1,289,776 tons at .13255 | | | 170,957.65 |

(f) Said basis of valuation as so determined by the Income Tax Unit was proposed to the representatives of said trustees for acceptance in settlement of the controversy in relation to the matter then pending before said Income Tax Unit and was accepted and expressly agreed to on behalf of said trustees with the understanding that such settlement and determination was subject to the approval of the Commissioner.

83 (g) Thereafter on March 17, 1925, the trustees received a letter from the Commissioner (IT:PA:3 EPR: 301) confirming said determination and basis of valuation for purposes of depletion and advising the trustees of the results of the audit by the Department of their books and accounts for income tax purposes for the years 1917 to 1921 inclusive based on said determination and upon the rates for depletion shown therein.

(h) After the receipt of said letter of March 17, 1925, confirming said settlement and determination of the basis of valuation of said mine for purposes of depletion, the trustees filed returns for the years 1922, 1923 and 1924 on the basis of said determination claiming a deduction of .13255 cents per ton for depletion in accordance therewith and the depletion claimed by them in their said amended return for the year 1923 in accordance with said determination and to which as they are informed and believe, they were lawfully entitled was the sum of $60,279.76.

(i) The facts upon which said rate of depletion was based shown in the statement and computation above referred to,

84 as petitioner is informed and believes, were substantially correct and entitled said trustees to the rate of depletion therein stated, to-wit, .13255 cents per ton.

(j) The ore taken from said mine under said lease for the year 1923 was 454,770 tons which at the rate of depletion established as aforesaid entitled the said trustees to a deduction of $60,279.76.

(k) Since the execution of said trust conveyance it has been the practice of the trustees thereunder as authorized and required by the terms thereof to make distribution of the entire royalties received by them under said lease from time to time among the beneficiaries of said trust in accordance with their respective interests as before stated after paying or reserving costs of administration and prior charges without reserving from such distribution the portion of such royalties corresponding to the proper allowance for depletion.

(l) In or about the year 1925 the income and profits tax return of the petitioner for the year 1923 was audited by the

department of internal revenue and in determining the
85 taxable income of the petitioner for that year derived by it from said trust the deduction of $60,279.76 taken by said trustees for depletion as aforesaid was accepted and confirmed and on the basis thereof and on the other facts disclosed in the return of petitioner for said year 1923 the deficiency in tax for said year 1923 was duly determined and was thereafter paid by the petitioner.

(m) Notwithstanding the foregoing, in the year 1927 the Commissioner undertook to reopen the audit of said return of petitioner and the determination of said deficiency for the year 1923 and upon such result erroneously disallowed the entire deduction claimed by said trustees for depletion for said year 1923 and redetermined the claimed deficiency in tax against the petitioner on the basis of such disallowance as shown in said notice, Exhibit "A".

(n) Petitioner alleges upon information and belief that the amount added to its taxable income for the year 1923 by reason of the disallowance to said trustees of said deduction of $60,279.76 for depetion was not in law and in fact income but represented a return to the petitioner by the trustees
86 under said trust conveyance pro tanto of its share of the corpus of the trust estate held by said trustees and that such addition to the taxable income of petitioner was erroneous.

(o) Petitioner further alleges upon information and belief that by reason of the facts hereinbefore stated the determination of the valuation of said mine for purposes of depletion and the depletion rates as aforesaid and the determination of the deficiency in tax based thereon for the year 1923 before referred to and the payment by the petitioner of the additional assessment based thereon as aforesaid should be held to be binding and conclusive upon the Commissioner, and that the reopening of said audit and determination of deficiency was erroneous and without justification.

Wherefore petitioner prays that this Board hear this proceeding; that the deduction for depletion taken by said trustees for the year 1923 be affirmed and allowed and that the tax liability of the petitioner for said year 1923 be redetermined accordingly, and that it be determined that the
87 petitioner is not liable for any deficiency in tax for said year 1923.

CHARLES F. FAWSETT
*Counsel for Petitioner.*

P. O. Address:
425 East Water Street,
Milwaukee, Wisconsin.

State of Wisconsin, }
Milwaukee County. } ss.

FRED VOGEL, JR., being first duly sworn, deposes and says that he is one of the officers, to wit, the Secretary of Elmwood Company of Delaware, the petitioner making the foregoing petition; that he makes this vertification as such officer for said petitioner and is duly authorized so to do; that he has read said petition and is familiar with the contents thereof and that the same is true of his own knowledge except as to matters therein stated on information and belief and as to those matters he believes them to be true.

FRED VOGEL, JR.

Subscribed and sworn to before me this 24 day of February, A. D. 1928.

(Seal)

OSCAR E. NELL,
*Notary Public, Milwaukee County, Wisconsin.*

88

EXHIBIT "A".

TREASURY DEPARTMENT
Washington

Jan. 7, 1928.

IT:FAR:A6
EIM:60D
Elmwood Company of Delaware,
C/o First Trust and Savings Bank,
Chicago, Illinois.

Sirs:

The determination of your tax liability for the year 1923 discloses a deficiency of $941.27 as shown by the attached statement.

In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C. and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assess-

ment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the enclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C. for the attention of IT:FAR:A6-EIM:60D. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR,
*Commissioner,*
By C. B. ALLEN,
*Deputy Commissioner.*

Inclosures:
Statement
Form A
Form 882

89 Statement.

IT:FAR:A6
EIM-60D

*In re:* Elmwood Company of Delaware
C/O First Trust and Savings Bank
Chicago, Illinois.

| Year | Deficiency in Tax |
|---|---|
| 1923 | 941.27 |

1923

| | | | |
|---|---|---|---|
| Net income as per return | | | 94,088.12 |
| 1. Liquidated dividend Ontonagon and Buele | $2,993.70 | | |
| Barth Manufacturing Co. | 698.48 | | |
| Calumet Land Company | 4,536.00 | | |
| 2. Additional distributive share from Pfister, Smith and Mariner | 13,556.86 | | |
| 3. Disallowance of proportionate share of loss in the operations of Pfister and Mariner Lands | 733.96 | | 22,519.00 |
| | | | 116,607.12 |

Explanation of Items Changed.

1. These amounts represent liquidating dividends received during 1923 and are held to be taxable income since they represent cash distribution over cost of each investment. Article 1544, Regulation 62

2. An audit of the amended return of the Pfister, Smith and Mariner Trustees for 1923 has ben made, and the net income was increased $60,279.76, representing depletion disallowed. The corrected net income of the Trust is $128,536.66 of which the Elmwood Company of Delaware holds a 1/8 interest.

| | |
|---|---|
| 1/8 of $128,536.66 | $16,067.08 |
| Amount of income reported from Trust | 2,510.22 |
| | 13,556.86 |

90 3. Loss on Pfister and Mariner lands disallowed and this is a joint ownership and the corporation acts as a holding company for Mrs. Louise F. Vogel.

Computation of Tax.

| | |
|---|---|
| Net Income | $116,607.12 |
| Tax at 12½% | 14,575.89 |
| Tax previously assessed | 13,634.62 |
| Additional Tax | 941.27 |

Payment should not be made until a bill is received from the Collector of Internal Revenue for your district and remittance should then be made to him.

91 EXHIBIT "B".

TREASURY DEPARTMENT
Washington

Dec. 10, 1927.

IT:FAR:B-2
MLR
Pfister, Smith and Mariner, Trustees,
133 Mason Street,
Milwaukee, Wisconsin.

Sirs:

A review of your 1923 return of income Form 1041, has been completed in connection with an examination of your books of account and records.

The report of the Internal Revenue Agent in Charge at

Milwauke, Wisconsin, dated November 28, 1925, has been reviewed and approved for 1923 with the following exception:

It is found that depletion is not deductible from the distributive income of the trust since the terms of the trust agreement do not appear to meet the requirements outlined in Treasury Decision 2267, ARR 3959 (Cumulative Bulletin II-2, Page 162) and IT:2218 (Cumulative Bulletin III-2, Page 61).

The amount of $60,279.76 deducted for depletion is therefore added to the net income reported in the amended Form 1041, resulting in a revised distributive income of $128,536.66 which will be apportioned among the beneficiaries as follows:

| | |
|---|---|
| Chas. F. Pfister | $16,067.08 |
| Elmwood Company of Delaware | 16,067.08 |
| Ida Lane Smith | 32,134.16 |
| J. W. Mariner | 32,134.16 |
| A. M. Hoyt and Company | 25,707.34 |
| Alice C. Dane | 6,426.84 |

The beneficiaries will be duly notified of the adjustment in their individual income.

Respectfully,

C. B. ALLEN,
*Deputy Commissioner.*
By PORTER LINDER,
*Head of Division.*

92 * * * (Caption 35815) * *

## ANSWER.

Filed Apr. 16, 1928.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of this taxpayer, admits and denies as follows:

I. Admits the allegations contained in paragraph (I) of the petition.

II. Admits the allegations contained in paragraph (II) of the petition.

III. Admits the allegations contained in paragraph (III) of the petition.

IV. Denies the Commissioner erred in respect to the matters set forth in subdivisions (1) and (2) of paragraph (IV) of the petition.

V(a). Admits the allegations contained in subdivision (a) of paragraph (V) of the petition.

V(b). The Respondent for the want of information and

knowledge sufficient to form a belief as to the allegations contained in subdivision (b) of paragraph (V), denies the same.

93 V(c). Admits that at the time of the execution of said trust conveyance on November 29, 1916, said Bristol Mine was subject to a mining lease, but denies the remainder of the allegations contained in said subdivision (e) of paragraph (V) of the petition.

V(d). Denies the allegations contained in subdivision (d) of paragraph (V) of the petition.

V(e). Denies the allegations contained in subdivision (e) of paragraph (V) of the petition.

V(f). Denies the allegations contained in subdivision (f) of paragraph (V) of the petition.

V(g). Denies the allegations contained in subdivision (g) of paragraph (V) of the petition.

V(h). Denies the allegations contained in subdivision (h) of paragraph (V) of the petition.

V(i). Denies the allegations contained in subdivision (i) of paragraph (V) of the petition.

V(j). Denies the allegations contained in subdivision (j) of paragraph (V) of the petition.

V(k). Denies the allegations contained in subdivision (k) of paragraph (V) of the petition.

V(l). Denies the allegations contained in subdivision (l) of paragraph (V) of the petition.

V(m). Admits that the Commissioner disallowed the entire deduction taken by the trustees for depletion in the
94 year 1923, but denies the remainder of the allegations contained in subdivision (m) of paragraph (V) of the petition. Further denies that such disallowance was erroneous.

V(n). Denies the allegations contained in subdivision (n) of paragraph (V) of the petition.

V(o). Denies the allegations contained in subdivision (o) of paragraph (V) of the petition.

Denies generally and specifically each and every allegation contained in taxpayer's petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that taxpayer's appeal be denied.

C. M. CHAREST,
*General Counsel, Bureau of of Internal Revenue.*

Of Counsel:
SHELBY S. FAULKNER,
*Special Attorney, Bureau of Internal Revenue.*

7 Ida Lane Smith, *Petitioner,*
*vs.*
Commissioner of Internal Revenue, *Respondent.* } Docket No. 40426.

Appearances:

For Taxpayer: Charles F. Fawsett, Esq., R. S. Doyle, Esq.

For Comm'r.: P. A. Bayer, Esq.

DOCKET ENTRIES.

1928

Aug. 24—Petition received and filed. Taxpayer notified. (Fee paid)

Aug. 25—Copy of petition served on General Counsel.

Oct. 6—Answer filed by General Counsel.

Oct. 10—Copy of answer served on taxpayer. General Calendar.

1929

Aug. 30—Notice of the appearance of R. S. Doyle, attorney for taxpayer. See 28070.

1930

Jan 4—Hearing set Feb. 26, 1930.

Feb. 19—Motion for continuance to April 28, 1930 filed by taxpayer. (28070)

Feb. 20—Motion granted and set for hearing on April 28, 1930.

Apr. 23—Motion for continuance to May 21, 1930 filed by taxpayer. April 25, 1930 granted to May 21, 1930.

Apr. 28—Motion to transfer to the Milwaukee, Wisc. Circuit Calendar, filed by taxpayer. April 30, 1930 granted.

May 21—Hearing set July 8, 1931, Milwaukee, Wisc.

Jul. 8—Hearing had before Stephen J. McMahon, Div. 16 on merits. Submitted. Exhibits see Dkt. 28070. Stipulation of facts received. Consolidated for hearing and decision with dockets 28070, 34678, 35815, 34758, 34759 and 41089. Briefs due Oct. 1, 1930.

Jul. 25—Transcript of hearing of July 8, 1930, filed.

Sep. 10—Motion for extension to Nov. 1, 1930 to file brief, filed by taxpayer. Sep. 11, 1930 granted.

Oct. 1—Brief filed by General Counsel.

Oct. 21—Motion for extension to Dec. 1, 1930 to file brief, filed by taxpayer. October 22, 1930 granted.

Nov. 14—Brief filed by taxpayer.

1931

Oct. 7—Findings of fact and opinion rendered. Stephen J. McMahon, Div. 16. Judgment will be entered for the respondent.

Oct. 9—Decision entered. Stephen J. McMahon, Div. 16.

1932

Feb. 24—Stipulation to consolidate with dockets 28070, 34678, 34758, 34759, 35815 and 41089 for the purpose of review filed.

Feb. 24—Petition for review to U. S. Circuit Court of Appeals (7) with assignments of error filed by taxpayer.

Feb. 24—Proof of service filed.

Feb. 24—Praecipe with proof of service thereon filed.

95 * * (Caption 40426) * *

## PETITION.

Filed August 24, 1928.

The above named petitioner hereby petitions for redetermination of the proposed deficiency in tax of $5,557.41 against her for the years 1924, 1925 and 1926 set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:AR:B-11 WAW-60D) dated July 6, 1928, and as a basis for her proceeding alleges as follows:

I. The petitioner is a resident of the city of Milwaukee and a citizen of the state of Wisconsin residing at 411 Terrace Avenue, Milwaukee, Wisconsin, which is also her post office address.

96 II. The notice of deficiency a copy of which is attached and marked Exhibit "A" referred to above is dated July 6, 1928, and was on that date mailed to the petitioner.

III. The taxes in controversy are income and profits taxes claimed to be due from the petitioner for the calendar years 1924, 1925 and 1926 and the amount of such taxes in dispute is so much of said sum of $5,557.41 as results from the disallowance of depletion claimed as a deduction from distributable income to the petitioner of the net income of the Pfister, Smith & Mariner Trust for said years 1924, 1925 and 1926 referred to in the statement attached to said letter.

IV. The determination of tax set forth in said notice is based upon the following errors, namely:

(1) The Commissioner erred in disallowing the deduction for depletion claimed as a deduction from net income on the said trust returns for the years 1924, 1925 and 1926 and disallowing the deduction claimed by the petitioner in her returns for said years for her proportionate share of such depletion which should have been allowed on the returns of said trust in computing its net distributable income.

97 (2) The Commissioner erred in determining that the petitioner was liable for a deficiency tax for the years 1924, 1925 and 1926 in the sum of $5,557.41.

V. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) In the years 1924, 1925 and 1926 and prior thereto a certain iron ore mine located in the state of Michigan known as the Bristol Mine was held in trust by three trustees which said trust was known as the Pfister, Smith and Mariner Trust.

(b) The provisions of the trust conveyance by which said trust was created in so far as material to this proceeding were in substance as follows:

Said instrument was made, executed and delivered November 29, 1916, by which certain real estate in Michigan including said mine was conveyed to said three trustees in trust with full powers of sale, management and control and providing that after the payment of costs of administration and prior charges,

98 "All proceeds which shall come to the hands of the trustees from said property or from any use which may be made thereof, or from any source whatsoever hereunder as received by the trustees shall belong to and be the property of the beneficiaries hereunder, to be distributed and paid over to them in proportion to and in accordance with their respective interests as shown herein or as the same shall from time to time appear as hereinafter provided.

The beneficiaries of the trust hereby created and hereinbefore referred to and their respective interests hereunder at the time of the execution and delivery of this instrument are as follows:

| | |
|---|---|
| Jesse Hoyt Smith— | 1/4 |
| Lucinda W. Mariner— | 1/8 |
| John W. Mariner— | 1/8 |
| Charles F. Pfister— | 1/8 |
| Louise F. Vogel— | 1/8 |
| Executors and trustees under the last will and testament of Jesse Hoyt, deceased— | 1/4." |

On the 4th day of January, 1921, Jesse Hoyt Smith, the owner of a 1/4 beneficial interest under said trust deed as above shown died and this petitioner as the chief beneficiary under his will succeeded to said 1/4th interest, since which time her beneficial interest under said trust and in the net proceeds resulting therefrom has been one-fourth.

(c) At the time of the execution of said trust conveyance, to-wit, November 29th, 1916, said Bristol Mine
99 was subject to a mining lease for a term of upwards of 15 years, exceeding the life of said mine on the basis of estimated ore reserves and the established rules for determining the life of said mine, so that during the term of said lease it could be assumed that all of the ore in said mine would be taken out and disposed of under said lease.

(d) The sole income and entire proceeds derived from the trust estate since the execution of said trust conveyance has been the royalties payable by the lessees under said lease to the owners of the fee, who after said trust conveyance were the trustees under said conveyance. The royalty reserved in said lease was 19 cents per ton.

(e) In or about the month of February, 1925, in connection with the audit of the accounts of the trustees for the years 1917, 1918, 1919, 1920 and 1921 the basis of valuation of said Bristol Mine for purposes of depletion was revised and redetermined by the mineral section and other representatives of the Income Tax Unit of the Internal Revenue De-
partment in conference with duly authorized representa-
100 tives of said trustees with the result that the basis of valuation of said mine for purposes of depletion was determined by the department as follows:

| | | |
|---|---|---|
| Ore reserve 3/1/13 | | 3,556,732 Tons |
| Mined 3/1/13 to 11/29/16 | | |
| 1913 | 379,170 | |
| 1914 | 172,606 | |
| 1915 | 378,830 | |
| 1916 | 462,800 | 1,392,806 |
| Ore reserve 1129/16 | | 2,163,926 |
| Royalty rate—19 cents | | |
| Gross expected royalty | | $411,146.94 |
| Less 3% expected expense | | 12,334.37 |
| Net expected profit | | 398,811 57 |
| Factor—6%—4%—9 years— .719198 | | |
| None removed from Nov. 29, 1916 to Jan. 1, 1917 | | |

| | | | |
|---|---|---|---|
| Value royalties as at Jan. 1, 1917 | | | $286,824.48 |
| Less — 1917 | 188,689 Tons | $25,010.35 | |
| 1918 | 245,280 | 32,511.37 | |
| 1919 | 58,138 | 7,706.07 | |
| 1920 | 368,488 | 48,842.35 | |
| 1921 | 13,555 | 1,796.69 | 115,866.83 |
| | 874,150 | | |
| Residual value—1,289,776 tons at .13255 | | | 170,957.65 |

(f) Said basis of valuation as so determined by the Income Tax Unit was proposed to the representatives of said trustees for acceptance in settlement of the controversy in relation to the matter then pending before said Income Tax Unit and was accepted and expressly agreed to on behalf of said trustees with the understanding that such settlement and determination was subject to the approval of the Commissioner.

101 (g) Thereafter on March 17, 1925, the trustees received a letter from the Commissioner (IT:PA:3 EPR:301) confirming said determination and basis of valuation for purposes of depletion and advising the trustees of the results of the audit by the Department of their books and accounts for income tax purposes for the years 1917 to 1921 inclusive based on said determination and upon the rates for depletion shown therein.

(h) After the receipt of said letters of March 17, 1925, confirming said settlement and determination of the basis of valuation of said mine for purposes of depletion, the trustees filed returns for the years 1922, 1923, 1924, 1925 and 1926 on the basis of said determination claiming a deduction of .13255 cents per ton for depletion in accordance therewith.

(i) The facts upon which said rate of depletion was based shown in the statement and computation above referred to, as petitioner is informed and believes, were substantially correct and entitled said trustees to the rate of depletion therein stated, to-wit, .13255 cents per ton.

102 (j) Since the execution of said trust conveyance it has been the practice of the trustees thereunder as authorized and required by the terms thereof to make distribution of the entire royalties received by them under said lease from time to time among the beneficiaries of said trust in accordance with their respective interests as before stated after paying or reserving costs of administration and prior charges without reserving from such distribution the portion

of such royalties corresponding to the proper allowance for depletion.

(k) Petitioner alleges upon information and belief that said sum of $5557.41 added to her taxable income for the years 1924, 1925 and 1926 as the result of the disallowance of depletion by said trust as aforesaid were not in law or in fact income but represented to that extent a return to the petitioner of her share of the corpus of said Bristol Mine covered by said mining lease and that such addition to the taxable income of petitioner was erroneous and without authority of law.

Wherefore petitioner prays that this Board hear this proceeding; that the deduction for depletion taken by said
103 trustees for the years 1924, 1925 and 1926 for said Bristol Mine be affirmed and allowed, and that the deductions in the returns of the petitioner for the years 1924, 1925 and 1926 on account of her interest in said Bristol mine be allowed, and that the tax liability of the petitioner be determined accordingly and in accordance with the facts hereinbefore stated.

CHARLES F. FAWSETT
*Counsel for Petitioner.*

P. O. Address:
425 East Water Street,
Milwaukee, Wisconsin.

104 State of Wisconsin, }
Milwaukee County. } ss.

IDA LANE SMITH being first duly sworn says she is the petitioner making the foregoing petition; that she has read said petition and is familiar with the contents thereof and that the same is true of her own knowledge except as to matters therein stated to be on information and belief and as to those matters she believes it to be true.

IDA LANE SMITH

Subscribed and sworn to before me this 20 day of August, A. D. 1928.

(Seal)

C. F. MIKKELSON
*Notary Public, Milwaukee County, Wisconsin.*

105

EXHIBIT "A."

TREASURY DEPARTMENT
Washington

IT:AR:B-11
WAW-60D

Jul 6, 1928.

Mrs. Ida Lane Smith,
411 Terrace Avenue,
Milwaukee, Wisconsin.

Madam:

In accordance with Section 274 of the Revenue Act of 1926 you are advised that the determination of your tax liability for the years 1924, 1925 and 1926 discloses a deficiency of $5,557.41 as shown in the attached statement.

The section of the law above mentioned allows you an appeal to the United States Board of Tax Appeals within sixty days from the date of the mailing of this letter. However, if you acquiesce in this determination, you are requested to execute the inclosed Form A and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully,

D. H. BLAIR,
*Commissioner.*
By C. B. ALLEN,
*Deputy Commissioner.*

Inclosures:
Statement
Form A
Form 882.

106

Statement

IT:AR:B-11
WAW-60D

Jul 6, 1928

*In re*: Mrs. Ida Lane Smith
411 Terrace Avenue,
Milwaukee, Wisconsin.

| Year | Deficiency in Tax |
|---|---|
| 1924 | $1,049.53 |
| 1925 | 1,701.43 |
| 1926 | 2,806.45 |
| Total | $5,557.41 |

The report of the Internal Revenue Agent in Charge at Milwaukee, Wisconsin, covering an investigation of your tax liability for the years 1924 to 1926, inclusive, has been reviewed and approved by this office.

1924

| | | |
|---|---|---|
| Net income per return | | $66,778.71 |
| Add: | | |
| 1. Fiduciary income | $3,661.34 | |
| 2. Royalties | 292.30 | |
| 3. Expense disallowed | 126.80 | 4,080.44 |
| Adjusted net income | | $70,859.15 |

Computation of Tax

| | | |
|---|---|---|
| Total net income | | $70,859.15 |
| Less: | | |
| Capital net gain | | 10,700.00 |
| Income subject to surtax | | $60,159.15 |
| Less: | | |
| Personal exemption | $ 1,000.00 | |
| Dividends | 34,799.20 | 35,799.20 |
| Balanec subject to normal tax | | $24,359.95 |
| 107 Tax at 2% on $4,000.00 | | $ 80.00 |
| Tax at 4% on $4,000.00 | | 160.00 |
| Tax on 6% on $16,359.95 | | 981.60 |
| Surtax on $60,159.15 | | 5,513.42 |
| Tax at 12½% on capital gain of $10,700.00 | | 1,337.50 |
| Total tax | | 8,072.52 |
| Less: | | |
| Earned income credit | $ 20.00 | |
| Tax paid at source | 466.66 | 486.66 |
| Net tax liability | | $7,585.86 |
| Original assessment | $6,503.36 | |
| Additional assessment | 32.97 | 6,536.33 |
| Deficiency | | $1,049.53 |

Explanation of Changes

1. You reported $2,872.26 as your distributive share of the net income of the Pfister, Smith and Mariner Trust,

whereas a review of the trust return discloses that the correct amount of $6,533.60. The increase results from the disallowance of depletion claimed as a deduction from distributable income on the trust return. Under the Revenue Acts of 1924 and 1926, the beneficiaries of an estate or trust are taxable on the amounts actually distributed to them without the benefit of any deduction for exhaustion of the corpus of the estate or trust. See Treasury Decision 3642, Cumulative Bulletin III-2, Page 184; Treasury Decision 3668, Cumulative Bulletin IV-1, Page 194; Income Tax Ruling 2218, Cumulative Bulletin IV-2, Page 61. This construction of the Revenue Acts has been sustained by various decisions of the United States Board of Tax Appeals. See appeal of Steffenson, Board of Tax Appeals, Volume 1, Page 979; appeal of McConnell, Board of Tax Appeals, Volume 3, Page 260.

2. The amount reported as royalties from the Gwinn Mine has been increased by $292.30, in accordance with the recommendation of the examining officer.

3. Legal expense in the amount of $126.80 incurred in connection with income tax matters has been disallowed as it constitutes a personal expense. The adjustment of this item has been explained in a previous report.

108 1925

| | | |
|---|---|---|
| Net income per return | | $51,624.81 |
| Add: | | |
| 1. Fiduciary income | $8,968.84 | |
| 2. Royalties | 58.06 | |
| 3. Expense disallowed | 1,250.00 | 10,276.70 |
| Total | | $61,901.51 |
| Deduct: | | |
| 4. Capital gain decreased | | 400.00 |
| Adjusted net income | | 61,501.51 |
| Computation of Tax | | |
| Total net income | | 61,501.51 |
| Less: | | |
| Capital net gain | | 3,670.00 |
| Income subject to surtax | | $57,831.51 |

| | | |
|---|---|---|
| Less: | | |
| Personal exemption | $ 1,500.00 | |
| Dividends | 36,368.90 | 37,868.90 |
| Balance subject to normal tax | | $19,962.61 |
| Normal tax at 1½% on $5,000.00 | | 60.00 |
| Normal tax at 3% on $4,000.00 | | 120.00 |
| Normal tax at 5% on $11,962.61 | | 598.13 |
| Surtax on $57,831.51 | | 4,074.73 |
| Tax at 12½% on capital net gain of $3,670.00 | | 458.75 |
| Total tax | | 5,311.61 |
| Less: | | |
| Earned income credit | $ 13.12 | |
| Tax paid at source | 451.30 | 464.42 |
| Net tax liability | | 4,847.19 |
| Original assessment | $2,975.21 | |
| Additional assessment | 170.55 | 3,145.76 |
| Deficiency | | $ 1,701.43 |

109 Explanation of Changes

1. Income reported from the Pfister, Smith and Mariner Trust has been increased by $8,968.64 resulting from the disallowance of the deduction claimed for depletion on the trust return. For explanation of this adjustment see Item #1 under 1924 above.

2. The deduction of $58.06 for depletion applied against royalties received from the Gwinn Mine has been disallowed in accordance with the recommendation of the examining officer.

3. This item consists of legal fees in the amount of $850.00 which has been disallowed as it constituted a personal expense and a capital loss of $400.00 which has been transferred from ordinary income and applied as a deduction from capital gain. These adjustments were explained in a previous report.

4. See explanation under Item #3 above.

1926

| | | |
|---|---|---|
| Net income per return | | $181,541.90 |
| Add: | | |
| 1. Fiduciary income | $11,050.78 | |
| 2. Expense disallowed | 175.00 | 11,225.78 |
| Adjusted net income | | 192,767.68 |

Computation of Tax

| | | |
|---|---|---|
| Total net income | | 192,767.68 |
| Less: | | |
| Capital net gain | | 80,565.94 |
| Income subject to surtax | | 112,201.74 |
| Less: | | |
| Personal exemption | $ 1,500.00 | |
| Dividends | 79,043.50 | 80,543.50 |
| Balance subject to normal tax | | 31,658.24 |
| Normal tax at 1½% on $4,000.00 | | $ 60.00 |
| Normal tax at 3% on $4,000.00 | | 120.00 |
| 110 Normal tax at 5% on $23,658.24 | | 1,182.91 |
| Surtax on $112,201.74 | | 14,100.35 |
| Tax at 12½% on capital net gain of $80,565.94 | | 10,070.74 |
| Total tax | | 25,534.00 |
| Less: | | |
| Earned income credit | $ 13.12 | |
| Tax paid at source | 480.04 | 493.16 |
| Net tax liability | | 25,040.84 |
| Tax previously assessed | | 22,234.39 |
| Deficiency | | 2,806.45 |

Explanation of Changes

1. Income reported from the Pfister, Smith and Mariner Trust has been increased by $11,050.78 resulting from the disallowance of the deduction claimed for depletion on the trust return. For explanation of this adjustment see Item #1 for 1924 above.

2. The amount of $175.00 claimed as a deduction for legal fees has been disallowed as it constituted a personal expense.

Payment should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

111 * * (Caption 40426) * *

ANSWER.

Filed Oct. 6, 1928.

The Commisioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of this taxpayer, admits and denies as follows:

I. Admits the allegations contained in paragraph (I) of the petition.

II. Admits the allegations contained in paragraph (II) of the petition.

III. Admits the allegations contained in paragraph (III) of the petition.

IV. Denies the Commissioner erred in respect to the matters set forth in subdivisions (1) and (2) of paragraph (IV) of the petition.

V(a). Admits the allegations contained in subdivision (a) of paragraph (V) of the petition.

V(b). The respondent for the want of information or knowledge sufficient to form a belief as to the allegations contained in subdivision (b) of paragraph (V), denies the same.

112 V(c). Admits that at the time of the execution of said trust conveyance on November 29, 1916, said Bristol Mine was subject to a mining lease, but denies the remainder of the allegations contained in subdivision (c) of paragraph (V) of the petition.

V(d). Denies the allegations contained in subdivision (d) of paragraph (V) of the petition.

V(e). Denies the allegations contained in subdivision (e) of paragraph (V) of the petition.

V(f) Denies the allegations contained in subdivision (f) of paragraph (V) of the petition.

V(g). Denies the allegations contained in subdivision (g) of paragraph (V) of the petition.

V(h). Denies the allegations contained in subdivision (h) of paragraph (V) of the petition.

V(i). Denies the allegations contained in subdivision (i) of paragraph (V) of the petition.

V(j) Denies the allegations contained in subdivision (j) of paragraph (V) of the petition.

V(k). Denies the allegations contained in subdivision (k) of paragraph (V) of the petition.

Denies generally and specifically each and every allegation contained in taxpayer's petition not hereinbefore admitted, qualified or denied.

113 Wherefore, it is prayed that taxpayers' appeal be denied.

C. M. CHAREST,
*General Counsel, Bureau of Internal Revenue.*

Of Counsel:
BYRON M. COON,
*Special Attorney, Bureau of Internal Revenue.*

8 The Elmwood Company of Delaware,
*Petitioner,*
*vs.*
Commissioner of Internal Revenue,
*Respondent.*
} Docket No. 41089.

Appearances:

For Taxpayer: Charles F. Fawsett, Esq., R. S. Doyle, Esq.

For Comm'r.: P. A. Bayer, Esq.

DOCKET ENTRIES.

1928

Oct. 17—Petition received and filed. Taxpayer notified. (Fee paid.)

Oct. 18—Copy of petition served on General Counsel.

Dec. 1—Answer filed by General Counsel.

Dec. 4—Copy served on taxpayer. General Calendar.

1929

Aug. 30—Notice of appearance of R. S. Doyle as counsel for taxpayer filed. See 28070.

1930

Jan. 4—Hearing set February 26, 1930.

Feb. 19—Motion for continuance to April 28, 1930 filed by taxpayer. See 34678. Feb. 20, 1930 granted to April 28, 1930.

Apr. 23—Motion for continuance to May 21, 1930 filed by taxpayer. See 28070. April 25, 1930 granted May 21, 1930.

Apr. 28—Motion to place on Field Calendar filed by taxpayer. April 30. 1930, granted.

May 3—Motion to place on Reserve Calendar filed by taxpayer.

May 21—Hearing set July 8, 1930 at Milwaukee, Wisc.

Jul. 8—Hearing had before Mr. McMahon—called on merits—stipulation of facts received. Consolidated with 34678, 35815, 34758, 34759, 40426. Briefs due October 1, 1930.

Jul. 25—Transcript of hearing of July 8, 1930 filed.

Sep. 10—Motion for extension to Nov. 1, 1930 to file brief, filed by taxpayer. September 11, 1930 granted.

Oct. 1—Brief filed by General Counsel. See 28070.

Oct. 21—Motion for extension to Dec. 1, 1930 to file brief, filed by taxpayer.

Nov. 14—Brief filed by taxpayer.

1931

Oct. 7—Findings of fact and opinion rendered. Judgment will be entered for the Commissioner. Judge McMahon, Div. 16.

Oct. 9—Decision entered, Div. 16, Mr. McMahon.

1932

Feb. 24—Stipulation to consolidate with dockets 28070, 34678, 34758, 34759, 35815 and 40426 for petition for review, filed.

Feb. 24—Petition for review by U. S. Circuit Court of Appeals (7) with assignments of error filed by taxpayer.

Feb. 24—Proof of service filed.

Feb. 24—Praecipe with proof of service thereon, filed.

114 * * (Caption 41089) * *

PETITION.

Filed Oct. 17, 1928.

The above named petitioner hereby petitions for a redetermination of the proposed deficiency in tax of $280.93 against the petitioner for the year 1926 as set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT: AR:A-5 NMP-60D) dated August 24, 1928, and as a basis of its proceeding alleges as follows:

I.

The above named petitioner is a corporation duly organized and existing under the laws of Delaware.

115

II.

The notice of deficiency a copy of which is attached marked Exhibit "A" referred to above is dated and was mailed to the petitioner August 24, 1928.

III.

The taxes in controversy are income and profits taxes claimed to be due from the petitioner for the calendar year 1926 and the amount of such taxes in dispute is the entire amount claimed as a deficiency in said notice, to-wit, the sum of $280.93.

IV.

The determination of said tax set forth in said notice is based upon the following errors, namely:

(1) The Commissioner erred in disallowing the deduction claimed in the return filed by Pfister, Smith and Mariner, Trustees for the year 1926 as depletion of an iron ore mine which was the subject of the trust referred to in said return with the result that one-eighth of said amount, being the beneficial interest of the petitioner under said trust was erroneously added to the taxable income of the petitioner for
116 the year 1926 as shown by said Exhibit "A" hereto annexed. Reference is made to the notice of the Commissioner to said Pfister, Smith and Mariner, Trustees, disallowing its said claim for deduction for the year 1926 on account of depletion of said iron ore mine.

(2) The Commissioner erred in determining that there is any deficiency in tax due from petitioner for the year 1926.

V.

The facts upon which petitioner relies as the basis of its proceeding are as follows:

(a) Since the year 1916 a certain iron ore mine located in the state of Michigan known as the Bristol Mine was held in trust by three trustees.

(b) The provisions of the trust conveyance by which said trust was created in so far as material to this proceeding were in substance as follows:

Said instrument was made, executed and delivered November 29, 1916, by which certain real estate in Michigan including said mine was conveyed to the trustees above re-

ferred to or their predecessors in trust with full powers
117 of sale, management and control and providing that after the payment of the costs of administration and prior charges:

"All proceeds which shall come to the hands of the trustees from said property or from any use which may be made thereof, or from any source whatsoever hereunder as received by the trustees shall belong to and be the property of the beneficiaries hereunder, to be distributed and paid over to them in proportion to and in accordance with their respective interests as shown herein or as the same shall from time to time appear as hereinafter provided.

The beneficiaries of the trust hereby created and hereinbefore referred to and their respective interests hereunder at the time of the execution and delivery of this instrument are as follows:

| | |
|---|---|
| Jesse Hoyt Smith— | 1/4 |
| Lucinda W. Mariner— | 1/8 |
| John W. Mariner— | 1/8 |
| Charles F. Pfister— | 1/8 |
| Louise F. Vogel— | 1/8 |
| Executors and trustees under the last will and testament of Jesse Hoyt, deceased— | 1/4." |

The petitioner has succeeded to and was in the year 1926 and is now the owner of the 1/8th interest of Louise F. Vogel referred to above.

(c) At the time of the execution of said trust conveyance, to-wit, November 29th, 1916, said Bristol Mine
118 was subject to a mining lease for a term of upwards of 15 years, exceeding the life of said mine on the basis of estimated ore reserves and the established rules for determining the life of said mine, so that during the term of said lease it could be assumed that all of the ore in said mine would be taken out and disposed of under said lease.

(d) The sole income and entire proceeds derived from the trust conveyance since the execution of said trust conveyance has been the royalties payable by the lessees under said lease to the owners of the fee, who after said trust conveyance were the trustees under said conveyance. The royalty rate reserved in said lease was 19 cents per ton.

(e) In or about the month of February, 1925, in connection with the audit of the accounts of the trustees for the years 1917, 1918, 1919, 1920 and 1921 the basis of valuation of said Bristol Mine for purposes of depletion was revised and redetermined by the mineral section and other represen-

tatives of the Income Tax Unit of the Internal Revenue Department in conference with duly authorized representa-
119 tives of said trustees with the result that the basis of valuation of said mine for purposes of depletion was determined by the department as follows:

| | | | |
|---|---|---|---|
| Ore reserve 3/1/13 | | | 3,556,732 Tons |
| Mined 3/1/13 to 11/29/16 | | | |
| 1913 | | 379,170 | |
| 1914 | | 172,006 | |
| 1915 | | 378,830 | |
| 1916 | | 462,800 | 1,392,806 |
| Ore reserve 11/29/16 | | | 2,163,926 |
| Royalty rate—19 cents | | | |
| Gross expected royalty | | | $411,146.94 |
| Less 3% expected expense | | | 12,334.37 |
| Net expected profit | | | 398,811.57 |
| Factor—6%—4%—9 years— .719198 | | | |
| None removed from Nov. 29, 1916 to Jan. 1, 1917 | | | |
| Value of royalties as at Jan. 1, 1917 | | | 286,824.48 |
| Less — 1917 | 188,689 Tons | $25,010.35 | |
| 1918 | 245,280 | 32,511.37 | |
| 1919 | 58,138 | 7,706.07 | |
| 1920 | 368,488 | 48,842.35 | |
| 1921 | 13,555 | 1,796.69 | 115,866.83 |
| | 874,150 | | |
| Residual value—1,289,776 tons at .13255 | | | 170,957.65 |

(f) Said basis of valuation as so determined by the Income Tax Unit was proposed to the representatives of said trustees for acceptance in settlement of the controversy in relation to the matter then pending before said Income Tax Unit and was accepted and expressly agreed to on behalf of said trustees with the understanding that such settlement and determination was subject to the approval of the Commissioner.

120 (g) Thereafter on March 17, 1925, the trustees received a letter from the Commissioner (IT:PA:3 EPR:301) confirming said determination and basis of valuation for purposes of depletion and advising the trustees of the results of the audit by the Department of their books and accounts for income tax purposes for the years 1917 to 1921 inclusive based on said determination and upon the rates for depletion shown therein.

(h) Since the receipt of said letter of March 17, 1925, confirming said settlement and determination of the basis of valuation of said mine for purposes of depletion, the trustees have filed returns based thereon including their return for the year 1926 in which a claim for deduction on account of depletion was made as shown therein.

(i) The facts upon which said rate of depletion was based shown in the statement and computation above referred to, as petitioner is informed and believes, were substantially correct and entitled said trustees to the rate of depletion therein stated, to-wit, .13255 cents per ton.

121 (j) Since the execution of said trust conveyance it has been the practice of the trustees thereunder as authorized and required by the terms thereof to make distribution of the entire royalties received by them under said lease from time to time among the beneficiaries of said trust in accordance with their respective interests as before stated after paying or reserving costs of administration and prior charges without reserving from such distribution the portion of such royalties corresponding to the proper allowance of depletion.

(k) Petitioner alleges upon information and belief that the amount added to its taxable income for the year 1926 by reason of the disallowance to said trustees of said deduction for depletion was not in law and in fact income but represented a return to the petitioner by the trustees under said trust conveyance pro tanto of its share of the corpus of the trust estate held by said trustees and that such addition to the taxable income of petitioner was erroneous.

Wherefore petitioner prays that this Board hear this proceeding; that the deduction for depletion taken by said
122 trustees for the year 1926 be affirmed and allowed and that the tax liability of the petitioner for said year 1926 be redetermined accordingly, and that it be determined that the petitioner is not liable for any deficiency in tax for said year 1926.

CHARLES F. FAWSETT
*Counsel for Petitioner.*

P. O. Address:
425 East Water Street,
Milwaukee, Wisconsin.

State of Wisconsin, } ss.
Milwaukee County. }

CHARLES P. VOGEL being first duly sworn, deposes and says that he is one of the officers to-wit, the vice-president of Elmwood Company of Delaware, the petitioner making the foregoing petition; that he makes this verification as such officer for said petitioner and is duly authorized so to do; that he has read said petition and is familiar with the contents thereof and that the same is true of his own knowledge except as to matters therein stated on information and belief and as to those matters he believes them to be true.

CHARLES P. VOGEL

Subscribed and sworn to before me this 15th day of October, A. D. 1928.

(Seal)

FRED FELBER
*Notary Public, Milwaukee County, Wisconsin.*

My Commission expires Sept. 19th, 1922.

123

EXHIBIT "A."

TREASURY DEPARTMENT

Washington

Aug. 24, 1928.

Elmwood Co. of Delaware,
C/o First Trust & Savings Bank,
Monroe & Dearborn Sts.,
Chicago, Illinois.

Sirs:

In accordance with Section 274 of the Revenue Act of 1926 you are advised that the determination of your tax liability for the year 1926 discloses a deficiency of $280.93, as shown in the attached statement.

The section of the law above mentioned allows you to petition the United States Board of Tax Appeals within sixty days from the date of the mailing of this letter for a redetermination of your tax liability. However, if you acquiesce in this determination, you are requested to execute the enclosed Form 866 and forward both original and duplicate to the

Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:-P-7.

Respectfully,
D. H. BLAIR,
*Commissioner.*
By (Signed) C. B. ALLEN,
*Deputy Commissioner.*

Enclosures
Statements
Form 866
" 882

124 Statement.

IT:AR:A-5
NMP—60D

*In re:* Elmwood Company of Delaware,
C/o First Trust & Savings
Bank, Monroe & Dearborn
Streets, Chicago, Illinois.

| Year | Deficiency in Tax |
|---|---|
| 1926 | $280.93 |

| | | |
|---|---|---|
| Net income reported on return | | $24,281.85 |
| Add: | | |
| 1. Increase in distributive share from Pfister, Smith & Mariner Trust | | 5,525.39 |
| Net income as adjusted | | 29,807.24 |

Explanation of Change.

1. As a result of the changes in the Pfister, Smith & Mariner Trust income the proportionate share of your corporation in the distributive income has been determined to be

| | |
|---|---|
| Amount reported | $8,330.95 |
| | 2,805.56 |
| Additional Inc. (Article 541, Regulations 69) | 5,525.39 |

Computation of Tax.

| | | |
|---|---|---|
| Net income as adjusted | | 29,807.24 |
| Income tax at 13½% | | 4,023.98 |
| Tax assessed, Account #402800 | $3,008.05 | |
| Tax assessed, List, January 21, 1928, Page 1, Line 0, #3 | 735.00 | 3,743.05 |
| Deficiency in Tax | | 280.93 |

Payment should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

125

October 31, 1927.

*In re* Elmwood Company of Delaware,
Chicago, Illinois.

Page 12

Computation of tax—1926 rates.

| Schedule 3 Income Tax | Year ended 12/31/26 |
|---|---|
| Net income taxable year Schedule 1 | $27,726.29 |
| Balance taxable at 13½% | 27,726.29 |
| Income tax | 3,743.05 |
| Total tax | 3,743.05 |
| Previously assessed | 3,008.05 |
| Additional to be assessed | 735.00 |

126 * * (Caption 41089) * *

28.

ANSWER.

Filed Dec. 1, 1928.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of this taxpayer, admits and denies as follows:

I. Admits the allegations contained in paragraph (1) of the petition.

II. Admits the allegations contained in paragraph (II) of the petition.

III. Admits the allegations contained in paragraph (III) of the petition.

IV. Denies the Commissioner erred in respect to the matters set forth in subdivision (1) and (2) of paragraph (IV) of the petition.

V(a) Admits the allegations contained in subdivision (a) of paragraph (V) of the petition.

V(b) The Respondent for the want of information and knowledge sufficient to form a belief as to the allegations contained in subdivision (b) of paragraph (V), denies the same.

127 V(c) Admits that at the time of the execution of said trust conveyance on November 29, 1916, said Bristol

Mine was subject to a mining lease, but denies the remainder of the allegations contained in subdivision (c) of paragraph (V) of the petition.

V(d) Denies the allegations contained in subdivision (d) of paragraph (V) of the petition.

V(e) Denies the allegations contained in subdivision (e) of paragraph (V) of the petition.

V(f) Denies the allegations contained in subdivision (f) of paragraph (V) of the petition.

V(g) Denies the allegations contained in subdivision (g) of paragraph (V) of the petition.

V(h) Denies the allegations contained in subdivision (h) of paragraph (V) of the petition.

V(i) Denies the allegations contained in subdivision (i) of paragraph (V) of the petition.

V(j) Denies the allegations contained in subdivision (j) of paragraph (V) of the petition.

V(k) Denies the allegations contained in subdivision (k) of paragraph (V) of the petition.

Denies generally and specifically each and every allegation contained in taxpayer's petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that taxpayer's appeal be denied.

(Signed) C. M. CHAREST,
C. M. Charest,
*General Counsel, Bureau of Internal Revenue.*

Of Counsel:
BYRON M. COON,
*Special Attorney.*

152 * * (Captions, Nos. 28070; 34678; 34758; 34759; 35815, 40426 and 41089.) * *

STIPULATION.

Filed at Hearing, July 8, 1930.

For the purposes of the hearing, trial and determination of the above cases now pending before the United States Board of Tax Appeals,

It Is Hereby Stipulated by and between the petitioners in said cases respectively and the Commissioner of Internal Revenue, respondent, as follows:

That the controverted issues or questions involved in all

of said cases are the same and depend for their determination on the same facts, and that all of said cases for the purposes of the hearing and determination of the questions involved may be consolidated and tried together on the following stipulation of facts, to-wit:

In addition to such facts alleged in the petitions in said cases as are submitted in the answers of the respondent,

It Is Stipulated as follows:

(1) The Pfister Land Company, the grantor, a Wisconsin corporation, pursuant to authority of the stockholders and directors thereof, executed a trust conveyance on the 29th day of November, 1916, a true copy of which is annexed hereto and marked "Exhibit A."

153 (2) That at the time of the execution of said trust conveyance, to-wit, November 29, 1916, the Bristol Mine referred to therein was subject to a mining lease for a term of upwards of fourteen years.

(3) The royalty rate reserved in said lease was 19 cents per ton. The sole question presented by these proceedings is whether the income under these leases during the years 1922 to 1926, both inclusive, as distributed to the petitioner beneficiaries under the trust, may be reduced by an amount equal to the rate agreed upon in Paragraph 8 below for depletion purposes by the petitioners and the respondent, if depletion as a matter of law is an allowable deduction to the beneficiary petitioners.

(4) Since the execution of said trust conveyance it has been the practice of the trustees thereunder as authorized and required by the terms thereof to make distribution of the entire royalties received by them under said lease from time to time among the beneficiaries of said trust in accordance with their respective interests as shown therein below, after paying or reserving costs of administration and prior charges, but without otherwise reserving from such distribution any portion of such royalties as a depletion

154 reserve.

(5) The petitioners waive all other issues or questions raised in their respective petitions in the above-entitled cases except the question of their right to deductions as claimed by them from taxable income on account of depletion.

(6) Ida Lane Smith, the petitioner in Docket Nos. 34758 and 40426, is the successor in right, title and interest under the trust deed to Jesse Hoyt Smith, a beneficiary under the trust deed of a one-quarter interest.

Elmwood Company, the petitioner in Docket No. 41089 and Docket No. 35815, is the successor in right, title and interest to Louise F. Vogel, a beneficiary under the trust deed of a one-eighth interest.

John W. Mariner, the petitioner in Docket No. 34759, in addition to the interest which he originally had under the trust deed, has succeeded to the right, title and interest of Lucinda W. Mariner of one-eighth, and the distributions under the trust deed have been made accordingly since such succession, which was prior to the year 1922.

(7) If as a matter of law the petitioners are entitled to any deduction from taxable income received during the years in question under the provisions of this trust for depletion of the ore reserves in said mine, the basis of such determination is correctly stated as follows:

| | | |
|---|---|---|
| Ore reserve, March 1, 1913 | 3,556,732 | tons |
| Mined March 1, 1913, to November 29, 1916 | 1,392,806 | " |
| Ore reserve November 29, 1916 | 2,163,926 | " |
| Royalty rate $0.19 per ton | | |
| Gross expected royalty | $411,145.94 | |
| Less 3% expected expense | 12,334.37 | |
| Net expected profit | 398,811.57 | |
| Rate 6% and 4%, life 9 years, Factor | .719198 | |
| Present Worth as of November 29, 1916 | 286,824.48 | |
| Depletion unit per ton | .13255 | |

(8) In the following schedule is shown the tons mixed from the said Bristol mine during the years in controversy, the royalties received by the trustees and the depletion sustained resulting from the application of the rate of $.13255 per ton applied to said production and income.

Depletion Schedule.

| Year | Tons Mined | Royalty Earned | Depletion Sustained |
|---|---|---|---|
| 1922 | 115,996 | $ 23,528.70 | $15,375.27 |
| 1923 | 453,803 | 130,898.66 | 60,151.59 |
| 1924 | 110,489 | 26,031.39 | 14,645.32 |
| 1925 | 270,649 | 50,837.10 | 35,874.52 |
| 1926 | 378,878 | 68,890.53 | 50,220.28 |

(9) The proportional interest of the petitioner beneficiaries in the trust income was as follows:

| Beneficiary | Year 1922 | 1923 | 1924 | 1925 | 1926 |
|---|---|---|---|---|---|
| Ida Lane Smith | ¼ | ¼ | ¼ | ¼ | ¼ |
| John W. Mariner | ¼ | ¼ | ¼ | ¼ | ¼ |
| Charles F. Pfister | ⅛ | ⅛ | ⅛ | ⅛ | ⅛ |
| Elmwood Company of Delaware | ⅛ | ⅛ | ⅛ | ⅛ | ⅛ |

156 (10) The parties hereto reserve the right to offer additional evidence at the hearing not inconsistent with the facts here stipulated.

CHARLES F. FAWSETT,
RICHARD S. DOYLE,
per C. F. F.
*Attorneys for the Petitioners.*
C. M. CHAREST,
by P. A. B.
*General Counsel, Bureau of Internal Revenue, Attorney for the Respondent.*

157 EXHIBIT A.

This Indenture, Made this 29th day of November, A. D. 1916, by and between Pfister Land Company, a corporation of the State of Wisconsin, with its principal office and place of business at the City of Milwaukee, in said State, party of the first part, and Charles F. Pfister, Jesse Hoyt Smith and John W. Mariner of Milwaukee, Wisconsin, parties of the second part, Witnesseth:

That the said party of the first part for and in consideration of the sum of One Dollar ($1.00), and other valuable consideration, to it in hand paid by the said parties of the second part, the receipt whereof is hereby confessed and acknowledged, has given, granted, bargained, sold, remised, released, aliened, conveyed and confirmed and by these presents does give, grant, bargain, sell, remise, release, alien, convey and confirm unto the said parties of the second part, and to their successors under the trust hereinafter created, the following described property, to-wit:

The following described land in the County of Dickinson, and State of Michigan:

The East Half of the Southwest Quarter (E. ½ of S. W. ¼) and the Northwest Quarter of the Southwest Quarter (N. W. ¼ of S. W. ¼) of Section Six (6), Township Thirty-nine (39)

North, of Range Twenty-eight (28) West; the South Half of the Southeast Quarter (S. ½ of S. E. ¼) of Section Fourteen (14), Township Thirty-nine (39) North, of Range Twenty-nine (29) West, except a strip of land thirty-three (33) feet wide off entire South line deeded April 12, 1913, to Township of Norway for highway purposes; the Northwest Quarter of the Northwest Quarter (N. W. ¼ of N. W. ¼) of Section Twenty-four (24), Township Thirty-nine (39) North, of Range Twenty-nine (29) West; the Southwest Quarter of the Southeast Quarter (S. W. ¼ of S. E. ¼) and the South Half of the Southwest Quarter (S. ½ of S. W. ¼) of Section Thirty-three (33), Township Forty-two (42) North, of Range Twenty-nine (29) West; the South Half of the Southwest Quarter (S. ½ of S. W. ¼) of Section Thirty-six (36), Township Forty-two (42) North, Range Twenty-nine (29) West; the Southwest Quarter (S. W. ¼), the West Half of the Southeast Quarter (W. ½ of S. E. ¼) and the Northeast Quarter of the Southeast Quarter (N. E. ¼ of S. E. ¼) of Section Four (4), Township Thirty-nine (39) North, of Range Thirty (30) West; the Northeast Quarter of the Northeast Quarter (N. E. ¼ of 158 N. E. ¼) of Section Twenty-eight (28), Township Forty (40) North, Range Thirty (30) West, subject to right-of-way granted to Chicago & Northwestern Ry. Co. December 8, 1882, right-of-way granted to Escanaba, Iron Mountain & Western Ry. Co. June 11, 1891, and right-of-way granted to Chicago, Milwaukee & St. Paul Ry. Co. January 5, 1901; the Southeast Quarter of the Northeast Quarter (S. E. ¼ of N. E. ¼) of Section Twenty-eight (28), Township Forty (40) North, of Range Thirty (30) West, subject to right-of-way granted to Chicago & Northwestern Ry. Co. December 8, 1882, and right-of-way granted to Chicago, Milwaukee & St. Paul Ry. Co. January 5, 1901; the West Half of the Southwest Quarter (W. ½ of S. W. ¼) and the South Half of the Southeast Quarter (S. ½ of S. E. ¼) of Section Twenty-five (25), Township Forty-two (42) North, of Range Thirty (30) West, and the South Half of the Southeast Quarter (S. ½ of S. E. ¼) of Section Thirty-five, Township Forty-two (42) North, of Range Thirty (30) West, subject to right-of-way granted to Milwaukee Northern Ry. Co. September 21, 1888.

The following described real estate in the County of Iron, and State of Michigan:

The Southwest Quarter of the Northwest Quarter (S. W. ¼ of N. W. ¼) of Section Five (5), Township Forty-two (42) North, of Range Thirty-two (32) West; the South Half of

the Northeast Quarter (S. ½ of N. E. ¼) and the Northwest Quarter of the Southwest Quarter (N. W. ¼ of S. W. ¼) of Section Six (6), Township Forty-two (42) North, of Range Thirty-two (32) West, subject to right-of-way granted to Chicago & Northwestern Railway Co. dated April 25, 1887, and to an easement granted to Peninsular Power Co. for an electric transmission line dated December 6, 1915; the Northwest Quarter of the Northwest Quarter (N. W. ¼ of N. W. ¼) and the Southwest Quarter of the Southwest Quarter (S. W. ¼ of S. W. ¼) of Section Eight (8), Township Forty-two (42) North, of Range Thirty-two (32) West; the Southwest Quarter of the Southwest Quarter (S. W. ¼ of S. W. ¼) of Section Three (3), Township Forty-three (43) North, of Range Thirty-one (31) West; the North Half of the Southeast Quarter (N. ½ of S. E. ¼) and the Southwest Quarter of the Southeast Quarter (S. W. ¼ of S. E. ¼) of Section Four (4) Township Forty-three (43) North, of Range Thirty-one (31) West; the Southeast Quarter of the Northeast Quarter (S. E. ¼ of N. E. ¼) of Section Twenty (20), Township Forty-three (43) North, of Range Thirty-two (32) West; the Southeast Quarter of the Northwest Quarter (S. E. ¼ of N. W. ¼) of Section Twenty-one (21), Township Forty-three (43) North, of Range Thirty-two (32) West, subject to right-of-way one hundred (100) feet wide granted to Paint River Ry. Co. July 18, 1890; the Southeast Quarter of the Southwest Quarter (S. E. ¼ of S. W. ¼) of Section Twenty-four (24), Township Forty-three (43) North, of Range Thirty-three (33) West, subject to an iron mining lease (with S. W. ¼ of S. W. ¼ of Sec. 24-43-33, and N. ½ of N. W. ¼ of Sec. 25-43-33) to The Fortune Lake Mining Co., expiring July 31, 1965, subject to a right-of-way one hundred (100) feet wide granted to Chicago, Milwaukee & St. Paul Ry. Co. dated January 9, 159 1915, and subject to an easement for an electrical transmission line granted to Peninsular Power Co. November 23, 1916; the North Half of the Northwest Quarter (N. ½ of N. W. ¼) of Section Twenty-five (25), Township Forty-three (43) North, of Range Thirty-three (33) West, subject to an iron mining lease (with S. ½ of S. W. ¼ of Sec. 24-43-33) to The Fortune Lake Mining Co., expiring July 31, 1965, and subject to a right-of-way one hundred (100) feet wide granted to Chicago, Milwaukee & St. Paul Ry. Co. January 9, 1915; the Northwest Quarter of the Northeast Quarter (N. W. ¼ of N. E. ¼) of Section Twenty-five (25), Township Forty-three (43) North, of Range Thirty-three (33) West; the Northeast Quarter of the Southeast Quarter (N. E. ¼ of S. E.

¼) of Section Nineteen (19), Township Forty-three (43) North, of Range Thirty-two (32) West, in the City of Crystal Falls, subject to a railway right-of-way one hundred (100) feet wide, date of granting of which is unknown, subject to a right-of-way one hundred (100) feet wide granted to Chicago, Milwaukee & St. Paul Ry. Co. dated June 10, 1901, subject to right-of-way one hundred (100) feet wide granted to Chicago, Milwaukee & St. Paul Ry. Co. dated January 9, 1915, subject to an iron mining lease (with S. E. ¼ of S. E. ¼ of same section) to The Bristol Mining Company, expiring February 13, 1930, subject to a lease of the surface to The Bristol Mining Company expiring February 13, 1930, and subject to an easement for an electric transmission line granted to Peninsular Power Company dated April 7, 1916; the Northwest Quarter of the Southwest Quarter (N. W. ¼ of S. W. ¼) of Section Twenty-one (21), Township Forty-three (43) North, of Range Thirty-two (32) West, and Lot Three (3) of said Section Twenty-one (21), Township Forty-three (43) North, of Range Thirty-two (32) West, in said City of Crystal Falls, both of above descriptions being subject to an iron mining lease to James Corrigan, Stevenson Burke and Price McKinney expiring December 31, 1917; and the Southwest Quarter of the Southeast Quarter (S. W. ¼ of S. E. ¼) of Section Twenty-nine (29), Township Forty-three (43) North, of Range Thirty-two (32) West, subject to right-of-way granted to Chicago, Milwaukee & St. Paul Ry. Co. dated June 7, 1907.

All right, title and interest in and to the following described real estate in the County of Dickinson, and State of Michigan, such title and interest believed to be only the minerals contained in the said real estate and the right to enter, mine and remove the same:

The Northwest Quarter of the Northwest Quarter (N. W. ¼ of N. E. ¼) of Section Eighteen (18), Township Thirty-nine (39) North, of Range Twenty-eight (28) West; a strip of land thirty-three (33) feet wide deeded to Township of Norway for highway purposes April 12, 1913, along the entire center line of the South Half of the Southeast Quarter (S. ½ of S. E. ¼) of Section Fourteen (14) Township Thirty-nine (39) North, of Range Twenty-nine (29) West; the South Half of the Southwest Quarter (S. ½ of S. W. ¼) of Section Six (6), Township Forty (40) North, of Range Thirty (30) West; the North Half of the Northeast Quarter (N. ½ of N. E. ¼) and the Southeast Quarter of the Northeast Quarter (S. E. ¼ of N. E. ¼) of Section Eighteen
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(18), Township Forty (40) North, of Range Thirty (30) West; Lot one (1) of Section Twenty-eight (28), Township Forty (40) North, of Range Thirty (30) West subject to right-of-way granted to Chicago & Northwestern Ry. Co. dated December 8, 1882, and right-of-way granted to Chicago, Milwaukee & St. Paul Railway Co. dated January 5, 1901; and the North Half of the Southwest Quarter (N. ½ of S. W. ¼), the Southeast Quarter of the Northwest Quarter (S. E. ¼ of N. W. ¼) and Lots One (1) and Two (2) of Section Thirty-six (36), Township Forty (40) North, of Range Thirty (30) West.

All right, title and interest in and to the following described real estate in the County of Iron, and State of Michigan, such title and interest believed to be only minerals contained in the said real estate and the right to enter, mine and remove the same:

The Southeast Quarter of the Southeast Quarter (S. E. ¼ of S. E. ¼) of Section Four (4), Township Forty-three (43) North, of Range Thirty-one (31) West; the Southwest Quarter of the Southwest Quarter (S. W. ¼ of S. W. ¼) of Section Twenty-four (24), Township Forty-three (43) North, of Range Thirty-three (33) West, subject to an iron mining lease (with S. E. ¼ of S. W. ¼ of Sec. 24-43-33 and N. ½ of N. W. ¼ of Sec. 25-43-33) expiring July 31, 1965, granted to The Fortune Lake Mining Co., and the East Half of the Northeast Quarter (E. ½ of N. E. ¼) and the Southwest Quarter of the Northeast Quarter (S. W. ¼ of N. E. ¼) of Section Twenty-five (25), Township Forty-three (43) North, of Range Thirty-three (33) West; the Southeast Quarter of the Southeast Quarter (S. E. ¼ of S. E. ¼) of Section Nineteen (19), Township Forty-three (43) North, of Range Thirty-two (32) West, in the City of Crystal Falls, subject to an iron mining lease (with N. E. ¼ of S. E. ¼) of same section) to The Bristol Mining Company expiring February 13, 1930; the Northeast Quarter of the Northeast Quarter (N. E. ¼ of N. E. ¼) of Section Twenty-nine (29), Township Forty-three (43) North, of Range Thirty-two (32) West, in said City of Crystal Falls, subject to a railway right-of-way, date unknown; the Northwest Quarter of the Northeast Quarter (N. W. ¼ of N. E. ¼) of Section Twenty-nine (29), Township Forty-three (43) North, of Range Thirty-two (32) West, in said City of Crystal Falls, subject to a railway right-of-way, date unknown; the Southwest Quarter of the Northeast Quarter (S. W. ¼ of N. E. ¼) of Section Twenty-nine (29), Township Forty-three (43) North, of Range Thirty-two (32)

West, in said City of Crystal Falls, subject to a railway right-of-way, date unknown; the Southeast Quarter of the Northeast Quarter (S. E. ¼ of N. E. ¼) of Section Twenty-nine (29), Township Forty-three (43) North, of Range Thirty-two (32) West, in said City of Crystal Falls, subject to a railway right-of-way, date unknown, and to an iron mining option granted to J. J. Gaffney dated May 9, 1916, and expiring sixty days from November 1, 1916; the North-
161 west Quarter of the Southeast Quarter (N. W. ¼ of S. E. ¼) of Section Twenty-nine (29), Township Forty-three (43) North, of Range Thirty-two (32) West, in said City of Crystal Falls, subject to a railway right-of-way, date unknown; and the Northeast Quarter of the Northwest Quarter (N. E. ¼ of N. W. ¼) and the Northwest Quarter of the Northwest Quarter (N. W. ¼ of N. W. ¼) of Section Twenty-nine (29), Township Forty-three (43) North, of Range Thirty-two (32) West, in said City of Crystal Falls.

Together with all and singular the appurtenances thereunto belonging or in anywise appertaining, and all the estate, right, title, interest, claim and demand whatsoever of the said party of the first part either in law or equity, either in possession or expectancy.

In Trust, Nevertheless, for the uses and purposes and with and subject to the powers, directions and limitations hereinafter expressed, to-wit:

1. To have and to hold the said property and the appurtenances appertaining thereto subject to the powers, disposition and directions hereinafter contained unto the said parties of the second part, their successors or assigns, In Trust during the lives of Jesse Hoyt Smith and John W. Mariner, and of each of them, and for twenty-one (21) years thereafter.

2. The said parties of the second part, hereafter called the "Trustees," shall have and they are hereby granted full power to sell, convey, mortgage, lease, barter, exchange or otherwise dispose of said property, or any part thereof, including the power and authority to extend or renew existing leases, at such prices and upon such terms and conditions as they or a majority of them may deem best, and full power and authority to manage and control said property or such parts as may remain in their hands from time to time during the continuance of the trust in all respects
162 as the owners thereof subject only to their accountability hereunder as Trustees and the performance of their duties as such Trustees as herein expressed.

In case at any time during the term of the trust the revenues or proceeds from the trust estate in the hands of the Trustees, or which may reasonably be expected to accrue or come to their hands within the time as the same may be needed, shall not be sufficient to protect the property in their hands against any charges for assessments, taxes or any other charge whatsoever which if not paid or satisfied may result in the loss of the trust estate or any part thereof, the Trustees are authorized to make or levy such assessment upon the beneficiaries hereunder as may be required to pay or satisfy such charges and to fully protect the property in their hands from the liability to such loss, such assessment to be made ratably upon the beneficiaries in proportion to their respective interests.

Whenever any such assessment shall be made by the Trustees notice thereof shall be given to the beneficiaries by notice in writing properly addressed and duly mailed to each of them at his or her last known post office address. In case no response shall be received to such notice within thirty (30) days after the same shall have been mailed, a second such notice shall be mailed in like manner and in case any beneficiary shall not within thirty (30) days after such second notice shall have been mailed pay to the Trustees the amount so assessed, the interest of such beneficiary so 163 failing to pay his or her assessment may be sold by the Trustees at public auction to satisfy such assessment together with all costs which may be necessarily or properly incurred in making such sale. Such sale may be made upon such notice as shall be required by the laws of the State of Wisconsin in making sales of personal property under executions issued upon judgments except that in all cases besides the notice required in sales upon execution, notice in writing of the time and place of such sale shall be mailed to the beneficiary whose interest is to be sold not less than twenty (20) days before the time of such sale.

Upon any such sale being made any balance which may remain in the hands of the Trustees after retaining the amount of the assessment and all costs and expenses necessarily or properly incurred in connection with the sale shall be remitted to the beneficiary in the manner in which other remittances may be made as hereinafter provided.

3. The Trustees shall exercise their best judgment in the disposition, management and control of said property with the view to making sales at fair prices from time to time of such portions thereof as in their judgment should and may be

sold, and to provide for the proper exploration or development of such portions as in their judgment should be explored or developed for the discovery or recovery of iron ore or other mineral deposits which may be contained therein, and may conduct or authorize to be conducted such mining operations as in their judgment may be necessary or most advantageous for the interest of the beneficiaries here-
164 under in the recovery and marketing of any iron ore or other mineral deposits which may be discovered or contained in or upon the real estate hereinbefore described, and in the making of any leases which may be made therefor the term of such lease need not be limited to the term of the trust herein created but may be for such terms and conditions as the trustees may deem best. They may also make any expenditures out of proceeds in their hands for the improvement or development of said property in any manner whatsoever which in their judgment may be necessary or desirable to facilitate sales, or which they may deem to be otherwise to the advantage of the trust estate and for the interests of the beneficiaries hereunder.

They shall pay all taxes and lawful charges against or upon said property while the same shall remain in their hands during the term of the trust, and collect all rents, issues and profits including all royalties accrued or which may accrue under the mining leases under which portions of said real estate are now held, or under any leases which may hereafter be made of any portions of said real estate, including also the amounts due or which may become due for any sales or under any contracts for the sale of said property or any portion thereof.

4. Out of the proceeds which shall come to their hands, the Trustees shall be entitled to re-imbursement for all expenditures actually and properly made or incurred by them including office rent, clerk hire, counsel fees and all other expenses which may be lawfully and properly incurred
165 pursuant to the authority herein given. They are also authorized and directed to pay out of such proceeds all accounts payable by the party of the first part which shall not have been paid at the time of the execution and delivery hereof; also all charges, liabilities, costs or expenses incurred or which may hereafter be incurred by the party of the first part in any and all suits, actions or proceedings in court or otherwise heretofore begun or pending and to which the said party of the first part is a party, and generally to assume and pay any and all liabilities whatsoever of the party

of the first part existing at the time of the execution and delivery hereof or which may hereafter be incurred by it in any matter or proceeding now pending or begun prior to the execution and delivery hereof.

They shall also be entitled to retain a reasonable compensation for their services, and shall be entitled to retain from time to time such further sums as may be necessary or proper in their judgment to make provision for any expenditures or obligations about to be incurred in the proper performance of their duties hereunder, or for the protection of the property in their hands against all charges which may accrue in the future and for which it may be considered by them that the current revenues which the property may be yielding at the time may not be sufficient.

Except as above authorized to be expended, paid out or retained, all proceeds which shall come to the hands of the Trustees from said property or from any use which may be made thereof, or from any source whatsoever hereunder
166 as received by the Trustees shall belong to and be the property of the beneficiaries hereunder to be distributed and paid over to them in proportion to and in accordance with their respective interests as shown herein, or as the same shall from time to time appear as hereinafter provided.

5. The beneficiaries of the trust hereby created and hereinbefore referred to and their respective interests hereunder at the time of the execution and delivery of this instrument are as follows:

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|---|---|
| Jesse Hoyt Smith | One-Quarter |
| Lucinda W. Mariner | One-Eighth |
| John W. Mariner | One-Eighth |
| Charles F. Pfister | One-Eighth |
| Louise F. Vogel | One-Eighth |
| Executors of and Trustees under the Last Will and Testament of Jesse Hoyt, deceased | One-Quarter |

6. For the protection of the Trustees and to facilitate the administration of the trust, to be entitled to receive prompt remittance of their distributive shares of the proceeds of the trust which shall from time to time become distributable hereunder, the beneficiaries and each of them shall keep on file with the Trustees their respective names and post office addresses, and in distributing the proceeds hereunder such distribution may be made by mail by sending to each of the beneficiaries, the amount of his or her distributive share properly addressed and mailed to his or her last known post office

address. In case of a change in the interest of any bene-
167 ficiary, or any division of such interest, or in case of the acquisition of any interest hereunder by any other person, notice thereof in writing shall be given to the Trustees with satisfactory evidence of such division, change or acquisition, with the name, residence and post office address of the person or persons thereafter entitled and showing the interest of such person or persons. In any case in which the Trustees shall not be properly advised of the interest of any beneficiary or of his or her post office address, the share or shares of such person or persons shall be kept by the Trustees for the benefit of the person or persons who may prove to be entitled thereto and until in their judgment distribution thereof may be properly and safely made, without liability on the part of the Trustees for failure to make an earlier distribution or payment thereof to the persons entitled. In all cases in making distributions of any proceeds in their hands and in all other respects in the administration of the trust hereunder, the Trustees shall be entitled to consider, treat and deal with the persons last known to them as the beneficiaries hereunder as in fact the beneficiaries and their last known post office addresses as their proper post office addresses and shall not be liable or responsible for any error or mistake which may be made by them in that regard unless the person or persons complaining thereof shall have fully complied with the requirements hereof in keeping the Trustees properly advised both as to their interest and post office address as hereinbefore provided. Nothing herein contained shall prevent the Trustees in their discretion and as they may elect from paying over the distributive share of any
168 beneficiary hereunder to such beneficiary in person, or from dealing with any authorized agent or representative of any beneficiary within the scope of the authority of such agent or representative in all respects as they might deal with the beneficiary himself.

7. In all matters pertaining to the execution of the trust, the decision, determination or opinion of a majority of the Trustees shall be final and shall have the same effect as the unanimous decision, determination or opinion of all the Trustees, and any action which may be taken hereunder by the Trustees or a majority of them shall be final and binding upon all parties in interest hereunder and not subject to impeachment or review on any ground except for gross negligence or actual fraud. In all matters of a ministerial nature the Trustees or a majority of them may delegate to any one of

their number the power to act with the same effect as though such action had been taken by them unanimously, and any act done by any one of the Trustees if subsequently ratified or approved by a majority of them shall have the same force and effect as though such act had been done in the first instance by a majority or by all of the Trustees.

8. In case all of the property hereby conveyed in trust shall be disposed of by the Trustees in accordance with the power and authority herein granted before the expiration of the term of the trust hereinbefore specified, the trust hereby created shall in that event terminate subject only to the duty of the Trustees to account. The term of the trust hereinbefore specified may also be shortened in the manner following, to-wit:

169 Whenever persons owning or representing not less than fifty-one per cent (51%) of the entire beneficial interest hereunder shall file with the Trustees or deliver to them a request in writing that the trust be terminated, either forthwith, or at a time specified in such request within the period first herein mentioned, the trust shall terminate at the time specified in such request subject only to the duty of the Trustees to account and to make conveyance as hereinafter provided of any property which shall remain in their hands undisposed of and not then subject to distribution. Any property so remaining upon the expiration of the trust, whether terminated by request of the beneficiaries or by expiration of the term, shall upon such termination be conveyed by the Trustees by good and sufficient conveyance back to the Pfister Land Company, the party of the first part herein, and the Trustees shall thereupon be relieved and discharged of all liability hereunder whatsoever except to account for any proceeds which shall have come to their hands and for which they shall not therefor have accounted. Any such property so conveyed back to the party of the first part shall be subject to any claims or obligations or liabilities which may have been incurred by the Trustees in the administration of the trust hereunder and which shall not have been discharged before such reconveyance; provided, that in case the Trustees shall have faithfully performed their duties hereunder

170 they shall not be required to reconvey to the party of the first part any property which may remain in their hands before the expiration of the term of the trust first herein specified until all obligations or liabilities incurred by them as Trustees shall have been satisfied or a sufficient provision is made for the release of the Trustees from any such obliga-

tions or liabilities upon the assumption of the same by the party of the first part upon receiving such reconveyance. Conveyances executed by a majority of the Trustees shall have the same force and effect as though the same were executed by all of the Trustees.

8½. During the continuance of the trust the Trustees shall annually and as soon as practicable after the first day of April in each year mail to each of the beneficiaries at his or her last known post office address a statement showing the results of the administration of the trust for the preceding year, the assets and liabilities of the trust estate at the close thereof, the amounts received and disbursements during the year, and indicating the sources of the receipts and the purposes for which the disbursements were made.

9. On the death, resignation, removal or inability to act of any of the parties of the second part named herein as Trustees, or of any one who may hereafter become a Trustee hereunder during the term of the trust, steps to fill such vacancy shall be taken and the same shall be filled as follows:

171 It shall be the duty of the surviving Trustees or Trustee, except in the case of a removal of a Trustee by the stockholders, as above provided, to bring the fact of a vacancy in the Board of Trustees promptly to the attention of the party of the first part herein and its Board of Directors as then constituted shall have the authority to fill such vacancy, or they may do so without such notice from the Trustees if they have knowledge of the fact of such vacancy; provided, however, that if such directors shall fail to fill such vacancy within sixty (60) days after the fact thereof is brought to their knowledge, the surviving Trustees may appoint the third Trustee to fill such vacancy, or if it should happen that two of such Trustees should die leaving only one surviving, and the directors of the party of the first part should fail to fill the vacancies within sixty (60) days after notice thereof, the surviving Trustee may appoint two other Trustees to fill the vacancies; but whenever a vacancy in the office of Trustee shall be filled by the surviving Trustees or Trustee without the action of the Board of Directors of the party of the first part sanctioning or ratifying the same, notice thereof shall be given addressed to the last known post office address of each of the beneficiaries hereunder and at any time within sixty (60) days after such notices shall be been mailed, any beneficiary may object in writing to such appointment stating

fully the grounds of such objection, and thereupon such
172 appointment and the objection thereto shall be submitted to the Circuit Court of Milwaukee County as speedily as practicable or to one of the judges of said Court, and such appointment shall be subject to the approval or disapproval of the court or of such judge after giving the party or parties objecting and the Trustees or Trustee making such appointment an opportunity to be heard. In case no such objection is made the appointment so made without the action of the Board of Directors of the party of the first part shall become effective sixty (60) days after the same shall have been made and notice thereof given as aforesaid, and in case such objection shall be made, such appointment shall not become effective unless and until approved by the Circuit Court of Milwaukee County, or a judge thereof, as above provided, and if the objection or objections made shall be sustained, or for any reason the appointment made is disapproved by the court or such judge, the Circuit Court of Milwaukee County or a judge thereof upon application of the surviving Trustee or Trustees or of any beneficiary hereunder may fill the vacancy upon such notice to the parties in interest as may be directed by the court or such judge to whom the application is made.

10. Any person or corporation appointed hereunder as a Trustee in the manner provided herein to fill any vacancy which may occur in the office of Trustee hereunder, upon acceptance of the trust when such appointment is made by the Board of Directors of the party of the first part or
173 upon acceptance and the appointment becoming effective when otherwise made, as hereinbefore provided, shall have the same power and authority and be subject to the same duties and responsibilities as the parties of the second part named herein as Trustees.

In any case however the appointment of any trustee hereunder hereafter made shall be by an instrument in writing witnessed and acknowledged in the manner provided by law to entitle an instrument to be recorded in the office of the Register of Deeds and shall be duly recorded as an amendment to or modification of this conveyance.

No irregularity in the appointment of any Trustee hereunder or the failure to observe any formality or direction herein in the making hereof, nor involving actual fraud or bad faith shall in anywise affect the validity of such appointment unless objections thereto shall be made within sixty (60) days after notice of such appointment and within six

(6) months from the time when the instrument making such appointment shall have been recorded as above provided; and in all conveyances made or in any transactions with third persons, the validity of any such conveyance or the rights of third persons in such transactions shall not be affected by any such irregularity in the appointment of any trustee hereunder unless the grantee in such conveyance or the other party to such transaction shall have had actual notice of the irregularity and it shall have been of a substantial character materially affecting the rights of the beneficiaries hereunder.

11. In case the property retained by the party of the first part shall not yield sufficient revenue or the proceeds of sales thereof shall not be sufficient to pay the taxes upon its property and necessary running expenses, the Trustees hereunder are authorized and directed upon request of the party of the first part to advance to it as needed from time to time such sums of money as may be necessary to pay the taxes and charges upon the property and all necessary running expenses. All such advances shall be carried upon the books of the Trustees as an open account against said corporation, to be repaid as and when the proceeds of sales of property of the party of the first part or its circumstances may permit.

12. No bond shall be required of the Trustees hereunder or any of them in the first instance, but upon demand made in writing by any beneficiary hereunder the Trustees shall within thirty (30) days thereafter give a bond in such sum as may be demanded, not exceeding One Hundred Thousand Dollars ($100,000.00) in the aggregate, conditioned for the faithful performance of their duties hereunder as Trustees jointly and severally, with the party of the first part herein as obligee thereof with a surety company or surety companies authorized to transact business in the state of Wisconsin as surety or sureties. In case of the appointment of another Trustee hereunder to fill any vacancy a similar bond may be demanded for such new Trustee or the bond which may theretofore have been given if then in force may be amended or extended to cover the acts and conduct of such new Trustee. The expenses of obtaining such bond and the premiums required to keep the same in force shall be paid out of the proceeds in the hands of the Trustees as a part of the expenses of the trust. In case the Trustees or any Trustee required to give such bond shall fail to do so within thirty (30) days after such request, the office of such Trustee or Trustees so failing or refusing to give such bond shall there-

upon become vacant and another Trustee or other Trustees able and willing to give such bond shall be appointed in their place or places in the manner hereinbefore provided for filling vacancies, and upon the bond so requested being given by such succeeding Trustee or Trustees, the appointment so made to fill any such vacancy or vacancies shall become effective and complete; provided, that any bond which may be given hereunder shall be subject to the approval of the directors of the party of the first part, and no bond which shall be disapproved by them shall be a compliance with the requirements hereof.

In Witness Whereof the party of the first part has caused these presents to be duly executed by its president and secretary and its corporate seal to be affixed, and the parties of the second part in evidence of their acceptance of the trust have hereunto set their hands and seals the day and year first above written.

PFISTER LAND COMPANY,
By JOHN W. MARINER,
*President.*

Attest:
J. W. DADMUN
*Secretary*

In Presence of
J. N. KURTZ
A. M. STETTEN

JESSE HOYT SMITH (Seal)
CHARLES F. PFISTER (Seal)
JOHN W. MARINER (Seal)

Pfister Land Company
Seal on original document
OSCAR E. NELL
CHARLES BEHRENS, JR.

176 State of Wisconsin, } ss.
Milwaukee County. }

Personally came before me this 29th day of November, 1916, the above named John W. Mariner, president, and J. W. Dadmun, secretary of Pfister Land Company, to me known to be the persons who executed the foregoing instrument and acknowledged the same, and the said John W. Mariner and J. W. Dadmun being first duly sworn each for himself declared that said instrument so executed and acknowledged by them as such president and secretary of the Pfister Land

Company was so executed pursuant to a resolution duly adopted at a stockholders' meeting of said Pfister Land Company duly called and held at the office of the company on the 27th day of November, 1916, and that upwards of two-thirds of all of the outstanding stock of said company were duly represented at such meeting and voted in favor of such resolution and none to the contrary.

Acknowledged and subscribed and sworn to before me the day and year above written.

J. N. KURTZ,
*Notary Public, Milwaukee County, Wisconsin.*

Notarial seal of J. N. Kurtz affixed to original document. My commission expires July 6, 1919.

State of Wisconsin, } ss.
Milwaukee County. }

Personally came before me this 29th day of November, 1916, the above named Charles F. Pfister, Jesse Hoyt Smith and John W. Mariner, to me known to be the persons who executed the foregoing instrument and acknowledged the same.

J. N. KURTZ,
*Notary Public, Milwaukee County, Wisconsin.*

Notarial seal of J. N. Kurtz affixed to original document. My commission expires July 6, 1919.

128 * * (Captions Nos. 28070; 34678; 34758; 40426; 34759; 35815 and 41089.) * *

Promulgated October 7, 1931.

The beneficiaries of a trust who, as such, have no remainder interest in the trust corpus, are not entitled to depletion deductions because of the removal of iron ore from properties forming a part of the trust corpus.

Charles F. Fawsett, Esq., and Richard S. Doyle, Esq., for the petitioners.

P. A. Bayer, Esq., for the respondent.

These proceedings, which were consolidated for hearing, involve but one issue, namely, whether the beneficiaries of a trust are entitled to a pro rata deduction for depletion of the trust corpus. All other errors alleged in the several petitions were expressly waived and abandoned.

The calendar years involved and the deficiencies determined for each year are as follows:

A True Copy:

Teste

(Seal)

B. D. GAMBLE
*Clerk U. S. Board of Tax Appeals.*

| | Docket | Year | Deficiency |
|---|---|---|---|
| 129 | 28070 | 1922 | $ 848.30 |
| | 34678 | 1923 | 2,065.93 |
| | 34758 | 1923 | 7,590.58 |
| | 34759 | 1923 | 6,281.54 |
| | 35815 | 1923 | 941.27 |
| | 40426 | 1924 | 1,049.53 |
| | | 1925 | 1,701.43 |
| | | 1926 | 2,806.45 |
| | 41089 | 1926 | 280.93 |

Upon suggestion of death of the petitioner in docket numbered 28070, a motion was granted substituting the executors of the last will and testament of Charles F. Pfister as the party petitioner in this proceeding, being the same party appearing as petitioner in docket numbered 34678.

The proceedings were submitted upon the admissions of the pleadings and an agreed statement of facts.

## FINDINGS OF FACT.

On or about November 29, 1916, the Pfister Land Company, a Wisconsin corporation, pursuant to authority of its stockholders and directors, executed a trust conveyance whereby for a nominal consideration of one dollar and other valuable consideration it granted to Charles F. Pfister, Jesse Hoyt Smith and John W. Mariner, certain real property as therein described. The designated individuals were to hold the property in trust during the lives of said Smith and Mariner, and for twenty-one years thereafter, and, as trustees, they were given full power to sell, lease, mortgage or
otherwise dispose of the trust property, and had full
130 management and control thereof. After providing for
the payment of taxes and necessary expenses incident to administration, including compensation for the trustees, the trust deed provided:

Except as above authorized to be expended, paid out or retained, all proceeds which shall come to the hands of the

Trustees from said property or from any use which may be made thereof, or from any source whatsoever hereunder as received by the Trustees shall belong to and be the property of the beneficiaries hereunder to be distributed and paid over to them in proportion to and in accordance with their respective interests as shown herein, or as the same shall from time to time appear as hereinafter provided.

The beneficiaries named in the trust deed and their respective interests as created by said instrument were as follows:

| | |
|---|---|
| Jesse Hoye Smith | One-Quarter |
| Lucinda W. Mariner | One-Eighth |
| John W. Mariner | One-Eighth |
| Charles F. Pfister | One-Eighth |
| Louise F. Vogel | One-Eighth |
| Executors of and Trustees under the Last Will and Testament of Jesse Hoye, deceased | One-Quarter |

Upon the expiration of the trust by lapse of time or upon the happening of certain contingencies prior to such expiration, which said contingencies did not occur before or during the years in question and thus are not here material to the issue, the trustees were to convey any property remaining in the trust corpus back to the grantor corporation, Pfister Land Company.

At the time of the execution of said trust conveyance, to-wit, November 29, 1916, the Bristol Mine referred to therein was subject to a mining lease for a term of upwards of fourteen years. The royalty rates reserved in said lease was nineteen cents per ton.

The stipulated facts omitting the numbering of and changing the order of the paragraphs, read in part as follows:

131 If as a matter of law the petitioners are entitled to any deduction from taxable income received during the years in question under the provisions of this trust for depletion of the ore reserves in said mine, the basis of such determination is correctly stated as follows:

| | |
|---|---|
| Ore reserve, March 1, 1913 | 3,556,732 tons |
| Mined March 1, 1913, to November 29, 1916 | 1,392,806 " |
| Ore reserve November 29, 1916 | 2,163,926 " |
| Royalty rate $0.19 per ton | |
| Gross expected royalty | 411,145.94 |
| Less 3% expected expense | 12,334.37 |
| Net expected profit | 398,811.57 |
| Rate 6% and 4% life 9 years, Factor | .719198 |
| Present Worth as of November 29, 1916 | 286,824.48 |
| Depletion unit per ton | .13255 |

In the following schedule is shown the tons mined from the said Bristol mine during the years in controversy, the royalties received by the trustees and the depletion sustained resulting from the application of the rate of $.13255 per ton applied to said production and income.

Depletion Schedule

| Year | Tons Mined | Royalty Earned | Depletion Sustained |
|---|---|---|---|
| 1922 | 115,996 | $ 23,528.70 | $15,375.27 |
| 1923 | 453,803 | 130,898.66 | 60,151.59 |
| 1924 | 110,489 | 26,031.39 | 14,645.32 |
| 1925 | 270,649 | 50,837.10 | 35,874.52 |
| 1926 | 378,878 | 68,890.53 | 50,220.28 |

The proportional interest of the petitioner beneficiaries in the trust income was as follows:

| Beneficiary | Year | | | | |
|---|---|---|---|---|---|
| | 1922 | 1923 | 1924 | 1925 | 1926 |
| Ida Lane Smith | 1/4 | 1/4 | 1/4 | 1/4 | 1/4 |
| John W. Mariner | 1/4 | 1/4 | 1/4 | 1/4 | 1/4 |
| Charles F. Pfister | 1/8 | 1/8 | 1/8 | 1/8 | 1/8 |
| Elmwood Company of Delaware | 1/8 | 1/8 | 1/8 | 1/8 | 1/8 |

132 Since the execution of said trust conveyance it has been the practice of the trustees thereunder as authorized and required by the terms thereof to make distribution of the entire royalties received by them under said lease from time to time among the beneficiaries of said trust in accordance with their respective interests * * *, after paying or reserving costs of administration and prior charges, but without otherwise reserving from such distribution any portion of such royalties as a depletion reserve.

The petitioners waive all other issues or questions raised in their respective petitions in the above-entitled cases except the question of their right to deductions as claimed by them from taxable income on account of depletion.

Ida Lane Smith, the petitioner in Docket Nos. 34758 and 40426, is the successor in right, title and interest under the trust deed to Jesse Hoyt Smith, a beneficiary under the trust deed of a one-quarter interest.

Elmwood Company, the petitioner in Docket No. 41089 and Docket No. 35815, is the successor in right, title, and interest to Louise F. Vogel, a beneficiary under the trust deed of a one-eighth interest.

John W. Mariner, the petitioner in Docket No. 34759, in

addition to the interest which he originally had under the trust deed, has succeeded to the right, title and interest of Lucinda W. Mariner of one-eighth, and the distributions under the trust deed have been made accordingly since such succession, which was prior to the year 1922.

133 For the calendar years 1922 to 1926, inclusive, the fiduciary returns claimed depletion deductions based on a depletion rate of .13255 cents of each beneficiary by disallowing the depletion deductions and determined the deficiencies hereinbefore set forth.

## OPINION.

McMAHON: The sole issue presented by these proceedings is whether the beneficiaries of a trust are entitled to deductions for depletion because of iron ore removed from properties forming a part of the trust corpus.

The principle is well established by decisions of this Board and the Circuit Courts that beneficiaries of a trust are not entitled to reduce their distributive share of trust income because of depletion or depreciation of the trust corpus. *Detroit Trust Company, et al., Executors,* 16 B. T. A. 207; *George Snyder Crilly et al.,* 15 B. T. A. 642; *Gilbert B. Goff,* 18 B. T. A. 283; *Rita M. Kohler White et al.,* 23 B. T. A. 391; *Baltzell* v. *Mitchell,* 3 Fed. (2d) 428; certiorari denied, 268 U. S. 690; *Whitcomb* v. *Blair,* 25 Fed. (2d) 528; affirming *Louis P. V. Whitcomb et al.,* 4 B. T. A. 80; *Abell* v. *Tait,* 30 Fed. (2d) 54; *Hubbell* v. *Burnet,* 46 Fed. (2d) 446; affirming *F. C. Hubbell et al.,* 14 B. T. A. 1040; *Roxburghe* 134 v. *United States,* 64 Ct. Cls. 223; sections 214 (a) (10) and 234 (a) (9) of the Revenue Act of 1921; sections 214 (a) (9) and 234 (a) (8) of the Revenue Acts of 1924 and 1926; and section 215 (b) of the Revenue Acts of 1921, 1924 and 1926.

The petitioners base their claims for depletion deductions upon the decision of the Circuit Court for the Second Circuit in *Kate Fowler Merle-Smith et al.* v. *Commissioner,* 42 Fed. (2d) 837, overruling our decisions in *Kate Fowler Merle-Smith,* 11 B. T. A. 254, and *Margaret B. Fowler,* 11 B. T. A. 265. This Circuit Court decision was considered by the Board in the *Rita M. Kohler White* case, *supra,* in determining that the petitioners therein, who were beneficiaries of a testamentary trust, were not entitled to depreciation deductions because there was no provision in the will authorizing the trustees to retain a portion of the income to replace

wasting assets. The distinction between this Circuit Court's case and this Board case is that in the former the beneficiaries had an interest in the trust corpus as remaindermen, whereas in the latter, the beneficiaries had an interest only in the income.

In the instant case, as in the *White* case, the beneficiaries had no remainder interest in the trust corpus, because under the terms of the trust deed the trustees, upon the termination of the trust, were to convey back to the grantor corporation any remaining assets in the corpus.

The petitioners also contend that the trustees were merely agents of the beneficiaries in administering the trust and
135 paying over the proceeds. This argument is rebutted by the trust instrument, which in clear and unambiguous terms creates the trust, names the trustees, specifies in detail their duties, powers, and authority, and provides for the distribution of the proceeds to the beneficiaries in accordance with their respective interests.

In view of the foregoing discussion and the authorities cited we approve the action of the respondent.

Reviewed by the Board.

*Judgment will be entered for the respondent.*

1931. 136 * * (Caption 28070) * *

DECISION.

Pursuant to the determination of the Board, as set forth in its report promulgated October 7, 1931, it is

Ordered and Decided: That there is a deficiency of $848.30 for the year 1922.

(Signed) STEPHEN J. MCMAHON
(Seal) *Member.*

Enter: Oct-9 1931

137 * * (Caption 34678) * *

DECISION.

Pursuant to the determination of the Board, as set forth in its report promulgated October 7, 1931, it is

Ordered and Decided: That there is a deficiency of $2,065.93 for the year 1923.

(Signed) STEPHEN J. MCMAHON
(Seal) *Member.*

Enter: Oct-9 1931

138 * * (Caption 34758) * * Entered Oct. 9, 31

DECISION.

Pursuant to the determination of the Board, as set forth in its report promulgated October 7, 1931, it is

Ordered and Decided: That there is a deficiency of $7,590.58 for the year 1923.

(Signed) STEPHEN J. MCMAHON
*Member.*

(Seal)

Enter: Oct-9 1931

138½ * * (Caption 34759) * *

DECISION.

Pursuant to the determination of the Board, as set forth in its report promulgated October 7, 1931, it is

Ordered and Decided: That there is a deficiency of $6,281.54 for the year 1923.

(Signed) STEPHEN J. MCMAHON
*Member.*

(Seal)

Enter: Oct-9 1931

139 * * (Caption 35815) * *

DECISION.

Pursuant to the determination of the Board, as set forth in its report promulgated October 7, 1931, it is

Ordered and Decided: That there is a deficiency of $941.27 for the year 1923.

(Signed) STEPHEN J. MCMAHON
*Member.*

(Seal)

Enter: Oct-9 1931

140 * * (Caption 40426) * *

DECISION.

Pursuant to the determination of the Board, as set forth in its report promulgated October 7, 1931, it is

Ordered and Decided: That there are deficiencies as follows:

| Year | Amount |
|---|---|
| 1924 | $1,049.53 |
| 1925 | $1,701.43 |
| 1926 | $2,806.45 |

(Signed) STEPHEN J. McMAHON
*Member.*

(Seal)
Enter: Oct-9 1931

141 * * (Caption 41089) * *

DECISION.

Pursuant to the determination of the Board, as set forth in its report promulgated October 7, 1931, it is

Ordered and Decided: That there is a deficiency of $280.93 for the year 1926.

(Signed) STEPHEN J. McMAHON
*Member.*

(Seal)
Enter: Oct-9 1931

24, 1932. 143 * * (Captions, Nos. 28070; 34678; 34758; 34759; 35815; 40426 and 41089.) * *

PETITION FOR REVIEW OF DECISION OF THE BOARD OF TAX APPEALS.

Filed February 24, 1932.

To the Circuit Court of Appeals for the Seventh Circuit:

Your petitioners respectfully show:

First: This is a proceeding for review by the United States Circuit Court of Appeals for the Seventh Circuit of the decisions of the United States Board of Tax Appeals entered on October 9, 1931, redetermining deficiencies in income and profits taxes against the petitioners in the proceedings before said Board in the above entitled cases as follows:

In the proceeding, Docket No. 28070, for the year 1922, in the amount of $848.30.

144 In the proceeding, Docket No. 34678, for the year 1923, in the amount of $2,065.93.

In the proceeding, Docket No. 34758, for the year 1923, in the amount of $7,590.58.

In the proceeding, Docket No. 34759, for the year 1923, in the amount of $6,281.54.

In the proceeding, Docket No. 35815, for the year 1923, in the amount of $941.27.

In the proceeding, Docket No. 40426, for the year 1924, $1,049.53; for the year 1925, $1,701.43; and for the year 1926, $2,806.45.

In the proceeding, Docket No. 41089, for the year 1926 in the amount of $280.93.

Said proceedings involved a single issue which was the same in each of said proceedings except as to the taxable year and the amount of the deficiency involved, and for the purposes of the hearing and determination of said proceedings the same were consolidated before the Board of Tax Appeals, and by stipulation, filed herewith, have been consolidated for the purposes of this review.

Second: The individual petitioners in said proceedings were and are all residents of the city of Milwaukee,
145 county of Milwaukee, state of Wisconsin, and the Elmwood Company, the petitioner in the proceedings, Docket Nos. 35815 and 41089, is, and at all the times referred to herein, was a corporation duly organized and existing under the laws of the state of Delaware with its principal office and place of business in the city and county of Milwaukee in said state of Wisconsin. The income and profits tax returns for the taxable year or years involved in the above entitled proceedings and upon which said deficiencies as determined by said Board were based were all duly filed with the collector of internal revenue at Milwaukee, Wisconsin.

Third: The nature of the controversy before the Board of Tax Appeals was the determination of income and profits taxes due from petitioners respectively for the years involved in said proceedings as stated above, under the Revenue Act of the United States applicable thereto, involving the determination of the question as to whether or not the petitioners as beneficiaries of a trust were entitled to deductions from income for the purposes of their income taxes respectively, be-
cause of the removal of iron ore from an iron mine which
146 formed a part of the corpus of the trust. Said iron mine was subject to a long term mining lease under which the trustees as the owner of the fee were entitled to receive as royalty 19 cents per ton for each ton of ore removed from said mine during the year, and under the terms of the trust the proceeds of such royalties on receipt thereof by the trustees became the property of the beneficiaries under the trust, and the trustees were required to pay over and distribute the

same as received to such beneficiaries in accordance with their respective interests, after payment of taxes and deducting expenses of administration.

In accordance with the terms and requirements of the trust deed, the entire royalties as and when received by the trustees less taxes and expenses of administration were paid over and distributed to the petitioners as beneficiaries under said trust in accordance with their respective interests.

The sole question involved in the proceedings before the Board of Tax Appeals and requiring the determination of the Board was the question whether as matter of law the petitioners were entitled to deductions for depletion under the provisions of the applicable revenue acts for the taxable years involved.

147 Fourth: The errors committed by the Board of Tax Appeals upon which the petitioner relies as the basis of this proceeding are as follows:

1. The Board of Tax Appeals decided that as matter of law the petitioners as the beneficiaries of said trust were not entitled to any allowance or deduction from the proceeds of the royalties received by them in the years involved in said proceedings as aforesaid in the computation of taxable income, and that the entire proceeds of the said royalties received by them as aforesaid should be included in their incomes respectively for the years involved and subjected to the tax without any deduction for depletion of said mine due to the removal therefrom of the ore from which said royalties were derived. In so ruling and deciding the Board of Tax Appeals erred.

2. Pursuant to such determination the Board of Tax Appeals decided and ordered that there were and are deficiencies in tax against the petitioners in said proceedings as follows:

Against the petitioners in Docket No. 28070 for the year 1922 in the sum of $848.30.

Against the petitioners in the proceedings, Docket No. 34678 for the year 1923, in the sum of $2,065.93.

148 Against the petitioner in the proceeding, Docket No. 34758, for the year 1923, in the amount of $7,590.58.

Against the petitioner in the proceeding, Docket No. 34759 for the year 1923, in the sum of $6,281.54.

Against the petitioner in the proceeding Docket No. 35815 for the year 1923 in the sum of $941.27.

Against the petitioner in the proceeding, Docket No. 40426

for the year 1924 in the sum of $1,049.53; for the year 1925 in the sum of $1,701.43; for the year 1926 in the sum of $2,806.45.

Against the petitioner in the proceeding, Docket No. 41089 for the year 1926, in the sum of $280.93.

In so deciding and ordering the Board of Tax Appeals erred with respect to each of said determinations and orders.

3. The Board of Tax Appeals erred in deciding and ordering that there was or is any deficiency in tax against the petitioners for any of the years involved in any of said proceedings, or in deciding that there was any deficiency in tax whatsoever against any of the petitioners.

4. The Board of Tax Appeals erred in not ordering judgment for the petitioners in each of said proceedings in
149 its report promulgated October 7, 1931 and upon which its said decisions ordering said deficiencies were based.

5. The Board of Tax Appeals erred in not ordering and deciding in each of said cases described by docket number as above that there was no deficiency in tax against the petitioner or petitioners in said case for the taxable year or years involved therein.

Wherefore petitioners and each of them pray that this Court may review the action of the Board of Tax Appeals in this cause, reverse the decisions and each of the decisions of said Board and direct the entry of a decision or decisions by said Board in favor of the petitioners and of each of them determining that there is no deficiency in income or profits taxes for the years 1922 to 1926 inclusive, or for any of said years, due from the petitioners or from any of them, or for such other and further relief as may to this Court appear proper in the premises.

CHARLES F. FAWSETT,
R. S. DOYLE,
*Attorney for Petitioners.*

P. O. Address:
753 N. Water Street,

Milwaukee, Wisconsin.
150 State of Wisconsin, } ss.
Milwaukee County.

CHARLES F. FAWSETT being duly sworn says: I am the attorney for the petitioners in this proceeding. I prepared the foregoing petition and am familiar with the contents thereof. The statement of facts contained therein are true to the best of my knowledge, information and belief. This petition is not filed for purposes of delay and I believe the petitioners are and that each of them is justly entitled to the relief sought.

CHARLES F. FAWSETT.

Subscribed and sworn to before me this 18 day of February, 1932.

C. F. MIKKELSON,
(Seal) *Notary Public, Milwaukee County, Wisconsin.*

178 * * (Captions, Nos. 28,070; 34678; 34758; 34759; 35815; 40426 and 41089.) * *
32.

PRAECIPE FOR TRANSCRIPT.

Filed February 24, 1932.

To the Clerk of the United States Board of Tax Appeals:

You will please prepare a transcript of record in the above causes and on or before the 9th day of April, 1932, transmit the same to the Clerk of the Circuit Court of Appeals for the Seventh Circuit, and include in said transcript, copies, duly certified as correct, of the following documents:

1. The docket entries of proceedings before the Board in the above entitled proceedings;
2. Petitions for redetermination;
3. Respondent's answers.
4. Findings of fact and opinion of the Board, promulgated October 7, 1931.

179 5. Orders of redetermination entered October 9, 1931.

6. Petition for review by the United States Circuit Court of Appeals for the Seventh Circuit filed ....., 1932.

7. Stipulation of facts offered in evidence in said cases re-

ferred to in the report and opinion of the Board of Tax Appeals rendered therein including Exhibit A annexed thereto.

Said transcript to be prepared as required by law and the rules of the United States Circuit Court of Appeals for the Seventh Circuit.

CHARLES F. FAWSETT,
P. O. Address: 735 N. Water St.
Milwaukee, Wisconsin.
R. S. DOYLE,
832 Shoreham Bldg.,
Washington, D. C.
*Attorneys for Petitioners.*

Service of a copy of the foregoing is accepted this 24th day of February, 1932.

C. M. CHAREST,
*General Counsel, Bureau of Internal Revenue, Attorney for Respondent.*

180 * * (Caption, Nos. 28070; 34678; 34758; 34759; 35815; 40426 and 41089.) * *

CERTIFICATE.

I, B. D. Gamble, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages 1 to 180, inclusive, contain and are a true copy of the transcript of record, papers and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 29th day of March, A. D. 1932.

(Seal)

B. D. GAMBLE,
*Clerk.*

United States Circuit Court of Appeals for the Seventh Circuit

I, Frederick G. Campbell, clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing printed pages, numbered from 1 to 109, inclusive, contain a true copy of the printed record, printed under my supervision and filed on the twenty-second day of July 1932, on which the following-entitled cause was heard and determined: Charles F. Pfister (amended title, Otto H. Falk et al., Executors of the Estate of Charles F. Pfister, deceased) vs. Commissioner of Internal Revenue, No. 4766, October term, 1932, as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the city of Chicago, this 19th day of June, A.D. 1933.

[SEAL] FREDERICK G. CAMPBELL,
*Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.*

At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit, begun and held in the United States court room in the city of Chicago, in said Seventh Circuit, on the sixth day of October 1931, of the October term in the year of our Lord one thousand nine hundred and thirty-one, and of our independence the one hundred and fifty-sixth.

4766

CHARLES F. PFISTER (AMENDED TITLE OTTO H. FALK ET AL., EXECUTORS of the Estate of Charles F. Pfister, Deceased)

*vs.*

COMMISSIONER OF INTERNAL REVENUE

Petition for review of order of the United States Board of Tax Appeals

And on the fourth day of April 1932, there was filed in the office of the clerk of this court an appearance of counsel for petitioner, which said appearance is in the words and figures following, to wit:

United States Circuit Court of Appeals for the Seventh Circuit

No. 4766. October term, 1931

CHARLES F. PFISTER ET AL., PETITIONERS

*vs.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

The clerk will enter my appearance as counsel for the petitioner.

CHARLES F. FAWSETT,
*735 N. Water Street, Milwaukee, Wis.*

Endorsed: Filed April 4, 1932. Frederick G. Campbell, clerk.

And afterwards, to wit, on the fifth day of April 1932, there was filed in the office of the clerk of this court an appearance of counsel for respondent, which said appearance is in the words and figures following, to wit:

United States Circuit Court of Appeals for the Seventh Circuit

No. 4766. October term, 1931

CHARLES F. PFISTER (AMENDED TITLE OTTO H. FALK ET AL., EXECUTORS of the Estate of Charles F. Pfister, deceased) et al., petitioners

*vs.*

COMMISSIONER OF INTERNAE REVENUE, RESPONDENT

The clerk will enter appearances as counsel for the respondent.

G. A. YOUNGQUIST,
*Assistant Attorney General.*
C. M. CHAREST,
*General Counsel, Bureau of Internal Revenue.*
DWIGHT H. GREEN,
*Special Attorney, Bureau of Internal Revenue.*

Endorsed: Filed April 5, 1932. Frederick G. Campbell, clerk.

And afterwards, to wit, on the thirteenth day of July 1932, there was filed in the office of the clerk of this court a stipulation to amend the title, which said stipulation is in the words and figures following, to wit:

United States Circuit Court of Appeals for the Seventh Circuit

No. 4766

CHARLES F. PFISTER (OTTO H. FALK, JOSEPH E. UIHLEIN, CHARLES P. Vogel, and Louis Quarles, Executors of the Estate of Charles F. Pfister, Deceased), petitioners

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

*Stipulation*

It is hereby stipulated and agreed by and between the parties hereto that the title to the petition and the proceedings for review of the decision of the Board of Tax Appeals in the case of Charles F. Pfister v. Commissioner of Internal Revenue, docket no. 28070, be corrected to read, Otto H. Falk, Joseph E. Uihlein, Charles P. Vogel, and Louis Quarles, executors of the estate of Charles F. Pfister, deceased, petitioners, v. Commissioner of Internal Revenue, respondent, in accordance with the order of the Board of Tax Appeals dated October 3, 1931, copy of which is attached hereto and made a part hereof.

CHARLES F. FAWSETT,
*Counsel for Petitioners.*
C. M. CHAREST,
*Counsel for Respondent.*

Dated, July 9, 1932.

United States Board of Tax Appeals

Docket No. 28070

CHARLES F. PFISTER, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

*Order*

At the hearing of this proceeding on July 8, 1930, at Milwaukee, Wisconsin, counsel for the petitioner moved for a substitution of parties, stating that the petitioner, Charles F. Pfister, is now deceased, and counsel for the respondent agreed to this motion. It is therefore

*Ordered*, That Otto H. Falk, Joseph E. Uihlein, Charles P. Vogel, and Louis Quarles, executors of the estate of Charles F. Pfister, deceased, be, and hereby are, substituted as petitioners in this proceeding in the place and stead of Charles F. Pfister, deceased, and that the appeal shall proceed henceforth under the title of Otto H. Falk, Joseph E. Uihlein, Charles P. Vogel, and Louis Quarles, Ex-

ecutors of the Estate of Charles F. Pfister, Deceased, v. Commissioner of Internal Revenue.

(Signed) STEPHEN J. MCMAHON,
*Member.*

Dated, Washington, D.C., October 3, 1931.
Endorsed: Filed July 13, 1932. Frederick G. Campbell, clerk.

And on the same day, to wit, on the thirteenth day of July 1932, the following further proceedings were had and entered of record, to wit:

Wednesday, July 13, 1932

Court met pursuant to adjournment and was opened by proclamation.

Present: Hon. Samuel Alschuler, circuit judge; Hon. Evan A. Evans, circuit judge; Frederick G. Campbell, clerk; Henry C. W. Laubenheimer, marshal.

Before Hon. SAMUEL ALSCHULER, circuit judge

4766

CHARLES F. PFISTER, ETC.

*vs.*

COMMISSIONER OF INTERNAL REVENUE

Petition for review of order of the United States Board of Tax Appeals

Pursuant to stipulation of counsel, it is now here ordered that the title of this cause be corrected to read Otto H. Falk, James E. Uihlein, Charles P. Vogel, and Louis Quarles, Executors of the Estate of Charles F. Pfister, Deceased, petitioners, versus Commissioner of Internal Revenue, respondent, in accordance with the order of the Board of Tax Appeals dated October 3, 1931.

And afterwards, to wit, on the fourteenth day of September 1932, there was filed in the office of the clerk of this court an appearance of counsel for respondent, which said appearance is in the words and figures following, to wit:

No. 4766

United States Circuit Court of Appeals for the Seventh Circuit

October term, 1932.

CHARLES F. PFISTER, PETITIONER

*vs.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

The clerk will enter my appearance as counsel for respondent.

SEWALL KEY,
*Washington, D.C.*

Endorsed: Filed September 14, 1932. Frederick G. Campbell, clerk.

At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit begun and held in the United States court-room in the city of Chicago, in said Seventh Circuit on the fourth day of October 1932, of the October term in the year of our Lord one thousand nine hundred and thirty-two, and of our independence the one hundred and fifty-seventh.

And afterwards, to wit, on the sixteenth day of November 1932, there was filed in the office of the clerk of this court an appearance of counsel for the respondent, which said appearance is in the words and figures following, to wit:

United States Circuit Court of Appeals for the Seventh Circuit

No. 4766. October term, 1932

CHARLES F. PFISTER (AMENDED TITLE OTTO H. FALK ET AL., EXRS. OF the Estate of Charles F. Pfister, Deceased)

*vs.*

COMMISSIONER OF INTERNAL REVENUE

The clerk will enter our appearances as counsel for the respondent.

G. A. YOUNGQUIST,
*Assistant Attorney General.*
SEWALL KEY,
*Special Assistant to the Attorney Gen.*
J. LOUIS MONARCH,
*Special Asst. to the Attorney General.*
C. M. CHAREST,
*General Counsel, Bureau of Internal Rev.*
PHILIP A. BOYER,
*Special Atty., Bureau of Internal Rev.*

Endorsed: Filed November 16, 1932. Frederick G. Campbell, clerk.

And afterwards, to wit, on the tenth day of January 1933, the following further proceedings were had and entered of record; to wit:

Tuesday, January 10, 1933

Court met pursuant to adjournment and was opened by proclamation.

Present: Hon. Samuel Alschuler, circuit judge, presiding; Hon. Evan A. Evans, circuit judge; Hon. William M. Sparks, circuit judge; Hon. Walter C. Lindley, district judge; Frederick G. Campbell, clerk; Henry C. W. Laubenheimer, marshal.

Before Hon. EVAN A. EVANS, Circuit Judge; Hon. WILLIAM M. SPARKS, Circuit Judge; Hon. WALTER C. LINDLEY, District Judge

4766

OTTO H. FALK, EXECUTOR, ET AL.

*vs.*

COMMISSIONER OF INTERNAL REVENUE

Petition for review of order of the United States Board of Tax Appeals

It is ordered by the court that this cause be, and the same is hereby, set down for hearing on February 7, 1933.

And afterwards, to wit, on the seventh day of February 1933, the following further proceedings were had and entered of record, to wit:

Tuesday, February 7, 1933

Court met pursuant to adjournment and was opened by proclamation.

Present: Hon. Samuel Alschuler, circuit judge, presiding; Hon. Evan A. Evans, circuit judge; Hon. William M. Sparks, circuit judge; Hon. Walter C. Lindley, district judge; Frederick G. Campbell, clerk; Henry C. W. Laubenheimer, marshal.

Before Hon. SAMUEL ALSCHULER, Circuit Judge; Hon. EVAN A. EVANS, Circuit Judge; Hon. WALTER C. LINDLEY, District Judge

4766

OTTO H. FALK, EXECUTOR, ETC.

*vs.*

COMMISSIONER OF INTERNAL REVENUE

Petition for review of order of the United States Board of Tax Appeals

Now this day come the parties by their counsel and this cause now comes on to be heard on the printed record and briefs of counsel and

on oral arguments by Mr. Charles F. Fawsett, counsel for petitioner, and by Mr. J. Louis Monarch, counsel for respondent, and the court having heard the same takes this matter under advisement.

And afterwards, to wit, on the sixth day of March 1933, there was filed in the office of the clerk of this court the opinion of the court, which said opinion is in the words and figures following, to wit:

In the United States Circuit Court of Appeals for the Seventh Circuit

No. 4766. October term, 1932. January session, 1933

CHARLES F. PFISTER (AMENDED TITLE, OTTO H. FALK ET AL., Executors of the Estate of Charles F. Pfister, Deceased), petitioners

*vs.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for review of decisions of the United States Board of Tax Appeals

March 6, 1933

Before ALSCHULER and EVANS, Circuit Judges, and LINDLEY, District Judge

LINDLEY, District Judge:

This petition to review a decision of the United States Board of Tax Appeals involves seven applications of as many beneficiaries of a trust agreement for relief from assessments for deficiency in income taxes for each of the years 1922 to 1926, inclusive. These deficiencies arise out of the Board's refusal to allow the petitioners certain sums for depletion of the trust property. The amount of the sums deducted for such purpose and disallowed by the Board is not in controversy, and the sole question is whether petitioners were entitled to deduct the said items in making up their tax returns.

On November 29, 1916, the Pfister Land Company, a corporation, by authorized action, conveyed to trustees certain mineral property, with authority to sell, mortgage, or lease the same. After paying State and municipal taxes and the expenses of administration, the trustees were obligated to pay to petitioners as beneficiaries all income from the trust property. The land was then subject to a mining lease which continued until after the close of the period involved.

During the years in question the trustees collected the royalties provided in the lease and paid the same to the beneficiaries, without deduction of any sort except the taxes aforesaid and the comparatively small expenses of the trustees in administering their trust. In reporting the income thus received petitioners deducted the depletion items, which the Board refused to allow.

The pertinent revenue statutes of 1921, 1924, and 1926 provide that in computing net income there shall be allowed as a deduction in the case of mines "a reasonable allowance for depletion", which ordinarily is deducted by him who pays the tax. The evidence discloses that the mineral body was exhausted before the lease expired. Nothing of value remained for the trustees or the beneficiaries.

In Merle-Smith v. Commissioners, 42 Fed. (2nd) 837 (C.C.A. 2nd), certiorari denied, 282 U.S. 897, the court, having to do with a similar situation, said:

"The petitioners have a property right and interest, within the decision of Bryan v. Kennett, 113 U.S. 179, 5 S.Ct. 407, 28 L.Ed. 908, as real as that of the lessee referred to in Lynch v. Alworth-Stephens Co., supra. Their interest in the ore body is as direct as the interest of the lessor, which is contingent upon the fulfillment by the lessee of the obligations under its lease. Included in the current payment of royalties is a sum representing the value of each ton of ore removed. As stated in the Lynch case, allowance is to be made 'to everyone whose property right and interest therein has been depleted', and it would, therefore, seem that these petitioners should be allowed deductions for depletion, which their property interest sustained by reason of the mining operation.

"The Government accedes to the doctrine that in all mining operations there is some depletion. But whose ore is depleted is put into question. If the petitioners have any property interest in the corpus, it is being depleted. Certainly they who receive the income, the title owners of the corpus of the trust, the trustees, might have a depletion allowance. These petitioners who have the property right to which we have referred receive the royalties without deduction. The statutes provide for depletion. The trustees merely pass on the royalties received in the percentages the will requires of them. The terms of the trust require that the entire royalties be paid currently to the beneficiaries. No depletion reserve was to be set aside or retained by the trustees."

"A reasonable allowance for depletion should have been made to each of the petitioners in computing their income for the years in question."

We do not understand that the reason for the decision was that there was a remainder interest in the beneficiaries. Indeed, Judge Hand, in his concurring opinion, expressly disclaimed any intention to place the decision upon such ground.

Even though the existence of a right of remainder in the beneficiaries was material to the conclusion of the court in the case cited, it could hardly be said to be so here. In the instant case the only thing of value was the mineral; all this passed to the beneficiaries, and nothing of value remains in any one to which the depletion

could be said to be applicable. Their beneficial interest being the ore body, and their income having come entirely from the exhaustion of the same, it follows that they should be credited with the depletion or exhaustion of their capital assets. As said in Lynch v. Alworth-Stephens Co., 267 U.S. 364:

"Obviously, as the process goes on, this property interest of the lessee in the mines is lessened from year to year, as the owner's property interest in the same mines is likewise lessened. There is an exhaustion of property in the one case as in the other; and the extent of it, with the consequent deduction to be made, in each case is to be arrived at in the same way, namely, by determining the aggregate amount of the depletion of the mines in which the several interests inhere, based upon the market value of the product, and allocating that amount in proportion to the interest of each severally considered."

The depletion items represent the exhaustion of capital mineral assets—that is, the raw materials—all of which were exhausted within the period of the leasehold term and the proceeds, all of which passed to the beneficiaries. The trustees were permitted by law to pass on to their beneficiaries all royalties and retained nothing subject to tax. There was no title or interest in them against the exhaustion of which depletion would accrue. When Congress saw fit to place the beneficiaries in the category of owners to the extent that they might rightfully receive the proceeds of sale and taxed them thereon, it surely intended to pass on to them also the depletion of their capital assets as a reduction from the taxes assessed against the proceeds of sale thereof.

The decision of the Board of Tax Appeals is reversed with directions to allow the deductions claimed.

And on the same day, to wit, on the sixth day of March 1933, the following further proceedings were had and entered of record, to wit:

Monday, March 6, 1933

Court met pursuant to adjournment and was opened by proclamation.

Present: Hon. Samuel Alschuler, circuit judge, presiding; Hon. William M. Sparks, circuit judge; Hon. James H. Wilkerson, district judge; Frederick G. Campbell, clerk; Henry C. W. Laubenheimer, marshal.

Before Hon. SAMUEL ALSCHULER, Circuit Judge; Hon. EVAN A. EVANS, Circuit Judge; Hon. WALTER C. LINDLEY, District Judge

4766

OTTO H. FALK, JAMES E. UIHLEIN, CHARLES P. VOGEL, AND LOUIS QUARLES, Executors of the Estate of Charles F. Pfister, Deceased

*vs.*

COMMISSIONER OF INTERNAL REVENUE

Petition for review of order of the United States Board of Tax Appeals

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals and was argued by counsel.

On consideration whereof it is now here ordered and adjudged by this court that the decisions entered in this cause on October 9, 1931, by the United States Board of Tax Appeals, be, and the same is hereby, reversed, and that this cause be, and the same is hereby remanded to the said Board of Tax Appeals with directions to allow the deductions claimed.

And afterwards, to wit, on the twenty-fifth day of March 1933, there was filed in the office of the clerk of this court a petition for rehearing, which said petition for rehearing is not copied here.

And afterwards, to wit, on the thirty-first day of March 1933, there was filed in the office of the clerk of this court an answer to the petition for rehearing, which said answer to the petition for rehearing is not copied here.

And afterward, to wit, on the first day of May 1933, the following further proceedings were had and entered of record, to wit:

Monday, May 1, 1933

Court met pursuant to adjournment and was opened by proclamation.

Present: Hon. Samuel Alschuler, circuit judge, presiding; Hon. Evan A. Evans, circuit judge; Hon. William M. Sparks, circuit judge; Frederick G. Campbell, clerk; Henry C. W. Laubenheimer, marshal.

Before Hon. SAMUEL ALSCHULER, Circuit Judge; Hon. EVAN A. EVANS, Circuit Judge; Hon. WALTER C. LINDLEY, District Judge

4766

OTTO H. FALK ET AL., EXECUTORS, ETC.

*vs.*

COMMISSIONER OF INTERNAL REVENUE

Petition for review of order of the United States Board of Tax Appeals

It is ordered by the court that the petition for a rehearing in this cause be, and the same is hereby, denied.

United States Circuit Court of Appeals for the Seventh Circuit

I, Frederick G. Campbell, clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing typewritten and printed pages, numbered from 1 to 14, inclusive, contain a true copy of the proceedings had and papers filed (except briefs of counsel, stipulation and order relating to the filing of briefs, petition for a rehearing and the answer thereto) in the case of Charles F. Pfister (Amended Title Otto H. Falk et al., Executors of the Estate of Charles F. Pfister, Deceased) vs. Commissioner of Internal Revenue, No. 4766, October term, 1932, as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the city of Chicago, this 19th day of June, A.D. 1933.

[SEAL] FREDERICK G. CAMPBELL,
*Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.*

U. S. GOVERNMENT PRINTING OFFICE: 1933

*Order allowing certiorari*

Filed October 9, 1933

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted, and the case is assigned for argument immediately following nos. 145 to 150, inclusive.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE: 1933

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# In the Supreme Court of the United States

OCTOBER TERM, 1933

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NO. ——

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, Petitioner

*v.*

OTTO H. FALK ET AL., EXECUTORS OF THE ESTATE of Charles F. Pfister, Deceased

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**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF**

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**PETITION**

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit entered in the above-entitled cause on March 6, 1933, reversing the decisions of the Board of Tax Appeals.[1]

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[1] Seven petitions to review determinations of the Commissioner of Internal Revenue were consolidated for hearing before the Board of Tax Appeals. A separate order was

## QUESTION PRESENTED

Whether beneficiaries of a trust who have no interest in the trust corpus are entitled to a deduction for depletion of a mineral property constituting the corpus of the trust.

## STATUTES INVOLVED

The statutes involved will be found in the Appendix (*infra*, pp. 17–24).

## STATEMENT

The judgment below reversed the orders of the Board of Tax Appeals in seven cases which were consolidated for hearing. The facts are the same in all of the cases. They were stipulated (R. 79–97) and found by the Board (R. 98–101). They may be summarized as follows:

On November 29, 1916, the Pfister Land Company conveyed certain real property to Charles F. Pfister, Jessie Hoyt Smith, and John W. Mariner, as trustees, to hold the property in trust during the lives of Smith and Mariner and for 21 years thereafter (R. 82–96, 98). The trustees were given full power to sell, lease, mortgage, or otherwise dis-

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entered by the Board in each case (R. 102–104). One petition for review was filed in the Circuit Court of Appeals including all of the cases (R. 104–107), and a single judgment was entered reversing each of the decisions of the Board of Tax Appeals. Since the cases were all heard on the same record in the Circuit Court of Appeals, and a single judgment was entered by that court, a single petition is filed here under the same title by which the case was designated in the court below.

pose of the trust property and to exercise full powers of management and control. The trust deed provided that after payment of the expenses of administration, "all proceeds" should be distributed to the beneficiaries in accordance with their respective interests.

Upon the expiration of the trust by lapse of time or upon the happening of certain contingencies (none of which occurred before or during the taxable years here involved) the trustees were directed to convey the property remaining in the trust back to the grantor, the Pfister Land Company (R. 92, 99).

Part of the property conveyed to the trustees was known as the "Bristol Mine," and was subject to a mining lease for a term of more than fourteen years. The royalty rate reserved in this lease was nineteen cents per ton (R. 80, 99). The trustees distributed the entire amount of royalties received by them under this lease among the beneficiaries of the trust in accordance with their respective interests, without reserving from this distribution any sum as a depletion reserve (R. 80, 100).

For the calendar years 1922 to 1926, inclusive, the fiduciary returns made by the trustees showed depletion deductions based upon a depletion rate of 13.255 cents per ton.[2] The Commissioner dis-

[2] The amount of depletion to which the respondents are entitled, if such a deduction is allowable, has been stipulated and is not in dispute (R. 80, 99–100).

allowed this deduction and increased the distributive share of each beneficiary by a proportionate amount of the depletion deduction. Pursuant to this determination, he determined deficiencies against Charles F. Pfister for the years 1922 and 1923; against Ida Lane Smith for the years 1923, 1924, 1925, and 1926; against J. W. Mariner for the year 1923; and against the Elmwood Company of Delaware for 1923 and 1926 (R. 5, 16, 29, 41, 53, 64, 76, 101).

The Board of Tax Appeals sustained the deficiencies determined by the Commissioner (R. 102–104). The Circuit Court of Appeals held that the beneficiaries were entitled to a deduction for depletion and reversed the decision of the Board (R. 117–119).

## SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the respondents were entitled to a deduction for depletion of the corpus of the trust from which they received distributions of income.

2. In failing to hold that there is no statutory authority in the Revenue Acts of 1921, 1924, and 1926 for the allowance of a deduction for depletion to beneficiaries of a trust who receive distributions of trust income but have no remainder interest in the corpus of the trust.

## REASONS FOR GRANTING THE WRIT

1. In the case of *Anderson* v. *Wilson,* 289 U.S. 20, which arose under the Revenue Act of 1921, this Court held that a beneficiary of a trust should not be allowed a deduction for a loss suffered by the trust on the sale of trust property, notwithstanding the fact that the beneficiary might (in the discretion of the trustee) receive distributions of the proceeds of the sale of property belonging to the trust. Similarly, in *Abell* v. *Tait,* 30 F. (2d) 54 (C.C.A. 4th), certiorari denied, 279 U.S. 849, and *Baltzell* v. *Mitchell,* 3 F. (2d) 428 (C.C.A. 1st), certiorari denied, 268 U.S. 690, it was held under the Revenue Act of 1918 that there was no statutory authority for the allowance to beneficiaries of trusts of losses sustained on the sale of capital assets of the trust. It has likewise been held under these and later statutes that the beneficiary of a trust may not take a deduction on account of depreciation of trust assets. *Roxburghe* v. *United States,* 64 C.Cls. 223, certiorari denied, 278 U.S. 598; *Whitcomb* v. *Blair,* 25 F. (2d) 528 (App.D.C.); *Codman* v. *Miles,* 28 F. (2d) 823 (C.C.A. 4th), certiorari denied, 278 U.S. 654; *Hubbell* v. *Burnet,* 46 F. (2d) 446 (C.C.A. 8th), certiorari denied, 283 U.S. 840; *Codman* v. *Commissioner,* 50 F. (2d) 763 (C.C.A. 1st); *Roxburghe* v. *Burnet,* 58 F. (2d) 693 (App.D.C.), certiorari denied, 286 U.S. 567.

It is clear that Sections 214 and 219 of the Revenue Acts of 1921, 1924, and 1926 (*infra,* pp. 17–24),

involved in the cases at bar, are as lacking in any specific provision for the allowance of deductions for depletion to beneficiaries of trusts as they are in provisions for the allowance of deductions for depreciation and capital losses to beneficiaries. Hence, we believe that the case at bar is in conflict with the cases just cited.

2. The court below in deciding that respondents were entitled to depletion deductions relied upon *Merle-Smith* v. *Commissioner,* 42 F. (2d) 837 (C.C.A. 2d), certiorari denied, 282 U.S. 897. It is true that the beneficiaries in that case were allowed a deduction for depletion, but the decision was based in part on the fact that the principal beneficiary would soon receive part of the corpus with power to dispose thereof by will at any time before. Nor do we construe general statements in *Palmer* v. *Bender,* 287 U.S. 551, to the effect that depletion should be allowed in every case in which the taxpayer has acquired, by investment, an interest in the mineral in place as authority for the allowance of depletion to everyone deriving income from mineral property and therefore to the beneficiary of a trust. Hence, the question in this case does not seem to us to have been decided by these cases.

3. The question is one of general importance which arises under all of the Revenue Acts before

the Revenue Act of 1928.[3] A decision is required for the assistance of the Treasury Department in its administration of the law.

Wherefore, it is respectfully submitted that this petition should be granted.

J. CRAWFORD BIGGS,
*Solicitor General.*

JULY 1933.

[3] Section 23 (1) of the Revenue Act of 1928 provides for the apportionment of depletion between the beneficiaries and the trustee.

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## BRIEF IN SUPPORT OF PETITION

### OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 97–102) is reported in 24 B.T.A. 299. The opinion of the Circuit Court of Appeals (R. 117–119) is reported in 64 F. (2d) 171.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 6, 1933. A petition for a rehearing was denied May 1, 1933 (R. 121). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

### QUESTION PRESENTED, STATUTES INVOLVED, ETC.

A statement of the question presented, statutes involved, specification of errors to be urged, and a statement of the case will be found in the foregoing petition.

### ARGUMENT

In *Anderson* v. *Wilson*, 289 U.S. 20, this Court recognized that a trust estate was made a separate taxable entity under Section 219 of the Revenue Act of 1921 and that there was no provision in Section 214 or 219 of that Act under which a beneficiary of a trust might claim a deduction for a loss

on the sale of capital assets by the trustee. In that case the beneficiary actually received distributions of the proceeds of the sale of real property constituting a part of the corpus of the trust, but the Court nevertheless disallowed the claimed deduction. In so holding, the Court said (p. 26):

> We hold that the trust, and not the taxpayer, has suffered the loss resulting from the sale of the Commercial Building, and it follows that where loss has not been suffered, there is none to be allowed. Whether the result would be the same if the beneficiaries had been the owner of future estates in remainder, we are not required to determine. Cf. *Francis* v. *Commissioner*, 15 B.T.A. 1332, 1340. Our ruling will be kept within the limits of the case before us. In so ruling we do not forget that the trust is an abstraction, and that the economic pinch is felt by men of flesh and blood. Even so, the law has seen fit to deal with this abstraction for income-tax purposes as a separate existence, making its own return under the hand of the fiduciary and claiming and receiving its own appropriate deductions. The Revenue Act of 1921 under which the tax in question was imposed defines the word "taxpayer" as including a trust or an estate. Revenue Act of 1921, c. 136; 42 Stat. 227, sec. 2 (9). The definition is pursued to its logical conclusion in a long series of decisions. *Baltzell* v. *Mitchell*, 3 F. (2d) 428; *Whitcomb* v. *Blair*, 25 F. (2d) 528; *Abell* v.

> *Tait*, 30 F. (2d) 54; *Busch* v. *Commissioner*, 50 F. (2d) 800, 801; *Roxburghe* v. *Burnet*, 58 F. (2d) 693; cf. *Merchants Loan & Trust Co. v. Smietanka*, 255 U.S. 509. These and other cases bear witness to the rule that an equitable life tenant may not receive a deduction for the loss of capital assets of the trust, though the result of such a loss is a reduction of his income. The argument will not hold that what was lost to this taxpayer was not the capital of the trust, but rather his own capital, withdrawn from his possession, but held for his account by the executors as custodians or bailiffs. His capital was in the proceeds, to the extent that they were distributed, and never in the land. We do not pause to consider whether a statute differently conceived and framed would yield results more consonant with fairness and reason. We take the statute as we find it.

The Court there recognized that the allowance of a capital loss to an equitable life tenant was prohibited by the same principles that have been relied upon in disallowing depreciation of the trust assets to beneficiaries in such cases as *Whitcomb* v. *Blair*, 25 F. (2d) 528 (App.D.C.); *Roxburghe* v. *Burnet*, 58 F. (2d) 693 (App.D.C.), certiorari denied, 286 U.S. 567; *Roxburghe* v. *United States*, 64 C.Cls. 223, certiorari denied, 278 U.S. 598; *Codman* v. *Miles*, 28 F. (2d) 823 (C.C.A. 4th), certiorari denied, 278 U.S. 654; *Hubbell* v. *Burnet*, 46 F. (2d)

446 (C.C.A. 8th), certiorari denied, 283 U.S. 840; *Codman* v. *Commissioner*, 50 F. (2d) 763 (C.C.A. 1st).

It is evident that Section 219 of the various Acts here involved makes no provision for the allowance of either depreciation or depletion to beneficiaries of trusts. Under that section trusts are divided into several different classes according to the disposition to be made of the income. Where all or part of the income is retained and the fiduciary is taxed, the privilege of deducting depreciation and depletion is extended to the fiduciary under the provision that the income of the trust shall be taxed as that of an individual. But the privilege is not extended to the beneficiary where he, rather than the fiduciary, is taxed. On the contrary the beneficiary is required to report—

> that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not, * * *.

The respondents in this case were entitled to receive their full proportionate share of the net income of the trust. There is no provision in the trust instrument requiring the trustees to deduct any amount for depletion or other capital items before computing and paying to the beneficiaries their distributive share. Therefore, under a proper construction of the trust instruments, the trustees paid

the respondents their proportionate share of the trust income undiminished by deductions representing exhausted capital (R. 80). Irrespective of what the net income of the trust for any year might be, this distributive share[4] was the amount which Congress intended to be taxed. The beneficiary may not claim a deduction to which the fiduciary is entitled, for they are separate entities. *Anderson* v. *Wilson, supra.*

The only provision for the allowance of depletion under which deductions could be claimed in this case is Section 214 (a) (10) of the Act of 1921 (*infra,* pp. 17–18), and Section 214 (a) (9) of the Revenue Acts of 1924 and 1926 (*infra,* pp. 21, 24). None of those sections includes a provision for the allowance of depletion to equitable life tenants and the fact that in enacting Section 23 (1) of the Revenue Act of 1928, c. 852, 45 Stat. 791, 799, Congress found it desirable to include a specific provision for the allowance, indicates that it did not exist in the earlier statutes.

In *Palmer* v. *Bender,* 287 U.S. 551, this Court held that a lessee of oil wells who transfers them to

[4] The beneficiaries of this trust were entitled to receive all of the "proceeds" received by the trustees. This would include the right to the proceeds of the sale of the trust corpus, unless at the same time the holders of 51 per cent of the beneficial interest in the trust required its termination, in which event the proceeds would go to the Pfister Land Company. No point has been made of this and we consider it immaterial in view of *Anderson* v. *Wilson, supra.*

another, stipulating for a royalty or bonus from oil to be produced, thereby retains an economic interest in the oil in place which is depleted by production and which comes within the meaning and purpose of Section 214 (a) (10) of the Revenue Act of 1921, whether the conveyance be deemed by the law of the State a sublease or an assignment. In so holding the Court said (pp. 557–558):

> Similarly, the lessor's right to a depletion allowance does not depend upon his retention of ownership or any other particular form of legal interest in the mineral content of the land. It is enough if, by virtue of the leasing transaction, he has retained a right to share in the oil produced. If so he has an economic interest in the oil, in place, which is depleted by production. Thus, we have recently held that the lessor is entitled to a depletion allowance on bonus and royalties, although by the local law ownership of the minerals, in place, passed from the lessor upon the execution of the lease. See *Burnet* v. *Harmel, supra; Bankers Pocahontas Coal Co.* v. *Burnet, ante,* p. 308.

This decision, we submit, does not stand for the principle that a depletion allowance should be granted to everyone who receives income from mineral property. Moreover, if an actual investment in the property is a prerequisite to the allowance, the beneficaries in this case had none.

The court below seems to have given weight to the respondents' argument that since both the min-

ing lease and the term of the trust extended far beyond the life of the mine, there would be nothing left of the ore reserves after the termination of the trust and hence that the respondents had a property right in the oil reserves. But the evidence did not disclose that the mineral body was exhausted before the lease expired. It disclosed merely that if production had been continued at the rate of production applicable to the years here involved, the entire mineral body would have been exhausted before the lease expired (R. 81). In any event we submit that the right of the beneficiaries to the statutory allowance for depletion does not depend upon so variable a factor as the term of the particular trust; that it is incorrect to say that a beneficiary under a trust for a short term has no property right in the ore reserve but that his interest is different where the term of the trust extends beyond the life of the mine. The life of the mine depends upon the extent to which it is worked and the argument that a beneficiary's right to a depletion allowance depends upon the operating program of those who are actually working the mine seems to have little merit. The respondents' interest as beneficiaries of the trust was merely a right to receive income and would not be converted into a remainder interest even through the ceasing of income. The grantor is the remainderman.

It is our view that the fact that the beneficiaries in this case have no interest in the corpus as such

distinguishes the cases from *Merle-Smith* v. *Commissioner,* 42 F. (2d) 837 (C.C.A. 2d), certiorari denied, 282 U.S. 897, upon which the court below relied. In that case it was held that certain beneficiaries were entitled to royalties from mining property held in trust, but the principal beneficiary involved held a remainder interest in the corpus shortly to become vested and that fact was emphasized in the majority opinion,[5] though the court did consider that there was a distinction in the nature of depreciation and depletion deductions. Moreover, this distinction, which is emphasized in *Weiss* v. *Wiener,* 279 U.S. 333, and was said not to exist in *Ludey* v. *United States,* 274 U.S. 295, 303, seems insufficient to justify an allowance of depletion to beneficiaries having no interest in the corpus, where the statute does not specifically provide for the allowance to them. Depletion, like other deductions, may only be claimed to the extent that it is authorized by statute. *Burnet* v. *Thompson Oil & Gas Co.,* 283 U. S. 301.

## CONCLUSION

We submit that the decision of the Circuit Court of Appeals is incorrect and is in conflict with the

[5] The Bureau and the Board have accepted that decision as authority for allowing depletion to beneficiaries of a trust who have a remainder interest in the corpus. G.C.M. 9804, X-2 Cumulative Bulletin 353; G.C.M. 10273, XI-1 Cumulative Bulletin 169; *Mary Alphin* v. *Commissioner,* 21 B.T.A. 1101; *Ida L. Kuhn* v. *Commissioner,* 24 B.T.A. 216.

decisions of this Court and other Circuit Courts of Appeals, that the question involved is one of general importance, and that the petition for certiorari should be granted.

Respectfully submitted.

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JULY 1933.

## APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227, 239, 242, 246:

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * *

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further,* That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter: *And provided further,* That such depletion allowance based on discovery value shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made, except where such net income so computed is less

than the depletion allowance based on cost or fair market value as of March 1, 1913; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

* * * * *

SEC. 215. (b) Amounts paid under the laws of any State, Territory, District of Columbia, possession of the United States, or foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time, nor by any deduction allowed by this Act for the purpose of computing the net income of an estate or trust but not allowed under the laws of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holder is entitled.

SEC. 219. (a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income received by estates of deceased persons during the period of administration or settlement of the estate;

(2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;

(3) Income held for future distribution under the terms of the will or trust; and

(4) Income which is to be distributed to the beneficiaries periodically, whether or not

at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of section 214) there shall also be allowed as a deduction, without limitation, any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in paragraph (11) of subdivision (a) of section 214. In cases in which there is any income of the class described in paragraph (4) of subdivision (a) of this section the fiduciary shall include in the return a statement of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable to each beneficiary, whether or not distributed before the close of the taxable year for which the return is made.

(c) In cases under paragraphs (1), (2), or (3) of subdivision (a) or in any other case within subdivision (a) of this section except paragraph (4) thereof the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir, or other beneficiary. In such cases the

estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216.

(d) In cases under paragraph (4) of subdivision (a), and in the case of any income of an estate during the period of administration or settlement permitted by subdivision (c) to be deducted from the net income upon which tax is to be paid by the fiduciary, the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not, or, if his taxable year is different from that of the estate or trust, then there shall be included in computing his net income his distributive share of the income of the estate or trust for its taxable year ending within the taxable year of the beneficiary. In such cases the beneficiary shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the estate or trust.

(e) In the case of an estate or trust the income of which consists both of income of the class described in paragraph (4) of subdivision (a) of this section and other income, the net income of the estate or trust shall be computed and a return thereof made by the fiduciary in accordance with subdivision (b) and the tax shall be imposed, and shall be paid by the fiduciary in accordance with subdivision (c), except that there shall be al-

lowed as an additional deduction in computing the net income of the estate or trust that part of its income of the class described in paragraph (4) of subdivision (a) which, pursuant to the instrument or order governing the distribution, is distributable during its taxable year to the beneficiaries. In cases under this subdivision there shall be included, as provided in subdivision (d) of this section, in computing the net income of each beneficiary, that part of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable during the taxable year to such beneficiary.

* * * * *

Revenue Act of 1924, c. 234, 43 Stat. 253, 269, 272, 275:

SEC. 214. (a) In computing net income there shall be allowed as deductions:

* * * * *

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

(U.S.C., Title 26, Sec. 955.)

* * * * *

SEC. 215. (b) Amounts paid under the laws of any State, Territory, District of Columbia, possession of the United States, or foreign country as income to the holder of a life or terminable interest acquired by gift, be-

quest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time, nor by any deduction allowed by this Act for the purpose of computing the net income of an estate or trust but not allowed under the laws of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holder is entitled. (U.S.C., Title 26, Sec. 956.)

SEC. 219. (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that—

* * * * *

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) in the same or any succeeding taxable year;

* * * * *

(c) For the purpose of the normal tax the estate or trust shall be allowed the same credit as is allowed to a single person under subdivision (c) of section 216, and, if no part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, then in addition the same credits as are allowed by subdivisions (a) and (b) of section 216.

(d) If any part of the income of an estate or trust is included in computing the net income of any legatee, heir, or beneficiary, such legatee, heir, or beneficiary shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are, under this section, required to be included in computing his net income. Any remaining portion of such amounts specified in subdivisions (a) and (b) of section 216 shall, for

the purpose of the normal tax, be allowed as credits to the estate or trust.

(e) If the taxable year of a beneficiary is different from that of the estate or trust, the amount which he is required, under paragraph (2) of subdivision (b) of this section, to include in computing his net income, shall be based upon the income of the estate or trust for its taxable year ending within his taxable year. (U.S.C., Title 26, Sec. 960.)

Revenue Act of 1926, c. 27, 44 Stat. 9, 26, 28, 32:

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# In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 225

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

OTTO H. FALK, ET AL., EXECUTORS OF THE ESTATE OF CHARLES F. PFISTER, DECEASED

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT*

## BRIEF FOR THE PETITIONER

### OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 97–102) is reported in 24 B.T.A. 299. The opinion of the Circuit Court of Appeals (R. 117–119) is reported in 64 F. (2d) 171.

## JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 6, 1933. (R. 120.)[1] A petition for a rehearing was denied May 1, 1933. (R. 120–121.) The petition for a writ of certiorari was filed July 1, 1933, and was granted October 9, 1933 (R. 122). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTION PRESENTED

Whether beneficiaries of a trust receiving distributions of income are entitled to deductions for depletion of the mineral property constituting a part of the corpus of the trust.

## STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 26–34.

## STATEMENT

The judgment below reversed the orders of the Board of Tax Appeals in seven cases which were consolidated for hearing. The facts are the same in all

[1] Seven petitions to review determinations of the Commissioner of Internal Revenue were consolidated for hearing before the Board of Tax Appeals. A separate order was entered by the Board in each case. (R. 102–104.) One petition for review was filed in the Circuit Court of Appeals including all of the cases (R. 104–107), and a single judgment was entered reversing each of the decisions of the Board of Tax Appeals. Since the cases were all heard on the same record in the Circuit Court of Appeals, and a single judgment was entered by that court, a single petition was filed here under the title by which the case was designated in the court below.

the cases and were stipulated (R. 79–97) and found by the Board (R. 98–101) in substance as follows:

On or about November 29, 1916, the Pfister Land Company, a Wisconsin corporation, conveyed certain property to Charles F. Pfister, Jesse Hoyt Smith and John W. Mariner, as trustees, to hold in trust during the lives of Smith and Mariner and for twenty-one years thereafter. (R. 82–96, 98.) The trustees were given full powers of management with authority to sell, lease, mortgage or otherwise dispose of the trust property. After provision for the payment of taxes and necessary expenses incident to administration, including compensation for the trustees, the trust deed provided (R. 90):

> Except as above authorized to be expended, paid out or retained, all proceeds which shall come to the hands of the Trustees from said property or from any use which may be made thereof, or from any source whatsoever hereunder as received by the Trustees shall belong to and be the property of the beneficiaries hereunder to be distributed and paid over to them in proportion to and in accordance with their respective interests as shown herein, or as the same shall from time to time appear as hereinafter provided.

The beneficiaries named in the trust deed and their respective interests were as follows (R. 90):

| | |
|---|---|
| Jesse Hoyt Smith | One Quarter |
| Lucinda W. Mariner | One Eighth |
| John W. Mariner | One Eighth |
| Charles F. Pfister | One Eighth |
| Louise F. Vogel | One Eighth |
| Executors of and Trustees under the Last Will and Testament of Jesse Hoyt, deceased | One Quarter |

Before the years here involved Ida Lane Smith had succeeded to the interest of Jessie Hoyt Smith, the Elmwood Company had succeeded to the interest of Louise F. Vogel, and John W. Mariner, already owner of a one eighth interest, had succeeded to the interest of Lucinda W. Mariner. (R. 100–101.)

Upon certain conditions persons holding 51 percent of the beneficial interest in the trust could terminate it prior to the expiration of its term. Upon the expiration of the trust by lapse of time or otherwise, the trustees were directed to reconvey any property remaining in the trust to the settlor, the Pfister Land Company. (R. 92–93, 99.)

Part of the property conveyed to the trustees was known as the "Bristol Mine" and was subject to a mining lease for a term of about fourteen years. The royalty rate reserved in this lease was nineteen cents per ton. (R. 99.) The trustees have distributed the entire royalties received from the mine among the beneficiaries, according to their respective interests, except that they have paid or reserved costs of administration and prior charges. They have not reserved any portion of the royalties as a depletion reserve. (R. 80, 100.)

For the calendar years 1922 to 1926, inclusive, the fiduciary returns made by the trustees showed depletion deductions based upon a depletion rate of 13.255

cents per ton.[2] The Commissioner disallowed this deduction and increased the distributive share of each beneficiary by a proportionate amount of the depletion deduction. Pursuant to this action he determined deficiencies against Charles F. Pfister for the years 1922 and 1923 (R. 6, 16), against Ida Lane Smith for the years 1923, 1924, 1925, and 1926 (R. 29, 64); a deficiency against J. W. Mariner for the year 1923 (R. 41) and deficiencies against the Elmwood Company for 1923 and 1926 (R. 53, 76).

The Board of Tax Appeals sustained the deficiencies determined by the Commissioner. (R. 102–104.) The Circuit Court of Appeals held that the respondents were entitled to deductions for depletion and reversed the decision of the Board. (R. 120.)

**SPECIFICATION OF ERRORS TO BE URGED**

The Circuit Court of Appeals erred:

1. In holding that the respondents were entitled to a deduction for depletion of a mine constituting the corpus of a trust from which they received distributions of income.

2. In failing to hold that there is no statutory authority in the Revenue Acts of 1921, 1924 and 1926 for the allowance of a deduction for depletion to beneficiaries of a trust who receive distributions of trust income but have no remainder interest in the corpus of the trust.

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[2] The amount of depletion to which the respondents are entitled, if such a deduction is allowable, has been stipulated and is not in dispute. (R. 80, 99–100.)

## SUMMARY OF ARGUMENT

### I

The entire amount of royalty payments was income in the constitutional sense and the taxpayer is not entitled to a deduction unless the statute specifically authorized it. It has been established by many decisions of this Court that the entire proceeds from the working of a mine are income and may be subjected to taxation without any allowance on account of depletion. *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103; *Burnet* v. *Harmel*, 287 U.S. 103, 107–108. The taxpayer is therefore claiming a deduction from an item which is admittedly subject to tax as gross income. We submit that there is no provision in the Revenue Acts of 1921, 1924 or 1926 which allows a deduction to a taxpayer on account of depletion of a mine leased by a trust of which he is a beneficiary.

### II

Section 219 of the Revenue Acts of 1921, 1924 and 1926, relating to the taxability of trusts, contains no express provision that a beneficiary of a trust shall be allowed a deduction on account of depletion of trust property. Moreover, the section expressly provides that the beneficiary shall include in computing his tax that portion of the income of the trust which is distributable to him. The statute makes the beneficiary taxable on his distributive share, and on all of his distributive share. If Congress had intended that this share should be reduced on account of depletion sustained by the trust, it seems reasonable to suppose it would have said so.

In *Anderson* v. *Wilson*, 289 U.S. 20, this Court held that a trust was a separate entity under Section 219 of the Revenue Act of 1921 and that there was no provision in Section 214 of that Act under which an individual receiving income from a trust might be allowed a deduction for a loss resulting from a sale of trust property. The deduction for depletion is authorized by the same section of the statute as that involved in *Anderson* v. *Wilson*. We submit that the same principles that prevented the allowance of a deduction for a capital loss to the beneficiary in the *Wilson* case prohibited the allowance for depletion in this case.

It has been held in many cases that one taxpayer may not take a deduction properly allowable to another even though the "economic pinch" is ultimately felt by the former. Here, the mining property is owned by the trust and not by the beneficiaries, and the trust alone is entitled to the deduction. So far as beneficiaries of trusts are concerned, there is no reason for distinguishing between depletion and depreciation; and it has been held in many cases that beneficiaries of trusts may not take a deduction on account of depreciation of the trust property nor on account of a so-called "operating loss" of the trust.

The cases of *Palmer* v. *Bender*, 287 U.S. 551, and *Lynch* v. *Alworth-Stephens Co.*, 267 U.S. 364, recognizing that sublessors and lessees may be entitled to depletion, do not justify such an allowance to beneficiaries of trusts. Lessees have an investment in the mining property and are directly affected by re-

moval of the ore, while the beneficiaries in this case have only an equitable interest in the interest of the lessor, and suffer no loss of investment through depletion. The decision in *Merle-Smith* v. *Commissioner*, 42 F. (2d) 837 (C.C.A. 2d), certiorari denied, 282 U.S. 897, is contrary, we contend, to this Court's decision in *Anderson* v. *Wilson, supra*, since it disregarded the separate entity of trust and beneficiary in allowing deductions for depletion to the trust beneficiary.

## ARGUMENT

### I

### THE ENTIRE AMOUNT OF ROYALTY PAYMENTS WAS INCOME IN THE CONSTITUTIONAL SENSE AND THE TAXPAYER IS NOT ENTITLED TO A DEDUCTION UNLESS THE STATUTE SPECIFICALLY AUTHORIZES IT

The income involved in this case consists of royalties paid to the trustees under the terms of a lease of mining property. These royalties were paid in full to the beneficiaries of the trust without any deduction except for costs of administration. (R. 80, 100.) The only question in the case is whether the beneficiaries of the trust are entitled to deduct from the payments received any sum on account of depletion of the mine.

It has been established by many decisions of this Court that the entire proceeds from the working of a mine are income in the constitutional sense and may be subjected to taxation without any allowance on account of depletion. In *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103, the taxpayer contended that the income tax law of 1913 was unconstitutional

in its application to mining corporations because it made an inadequate allowance for depletion. But this Court rejected the taxpayer's contention. It held (pp. 113–114) that the argument

> rests upon the wholly fallacious assumption that looked at from the point of view of substance a tax on the product of a mine is necessarily in its essence and nature in every case a direct tax on property because of its ownership unless adequate allowance be made for the exhaustion of the ore body to result from working the mine. We say wholly fallacious assumption because independently of the effect of the operation of the Sixteenth Amendment it was settled in *Stratton's Independence* v. *Howbert*, 231 U.S. 399, that such a tax is not a tax upon property as such because of its ownership, but a true excise levied on the results of the business of carrying on mining operations (pp. 413 *et seq.*)

The same result was reached in several later cases, which, however, involved the Corporation Tax Act of August 5, 1909. *Von Baumbach* v. *Sargent Land Co.*, 242 U.S. 503; *Goldfield Consol. Mines Co.* v. *Scott*, 247 U.S. 126; *United States* v. *Biwabik Mining Co.*, 247 U.S. 116. So far as the constitutional question is concerned these cases are equally applicable to the question arising under an income tax act, as this Court pointed out in the quotation from *Stanton* v. *Baltic Mining Co.* set out above.

The rule of these cases has been recently reviewed by this Court in *Burnet* v. *Harmel*, 287 U.S. 103. This Court there said (pp. 107–108):

It was argued that since the net result of the mining operation is a conversion of capital investment as upon a sale, the money received by the corporate owner or lessor, being its capital in a changed form, could not rightly be deemed to be income. But that argument was rejected, both with respect to the proceeds of mining operations carried on by the corporate owner on its land, *Stratton's Independence* v. *Howbert, supra; Goldfield Consolidated Mines Co.* v. *Scott*, 247 U.S. 126; see *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103, 114, and with respect to payments made by the lessee to the corporate lessor under the provisions of a mining lease. *Von Baumbach* v. *Sargent Land Co.*, 242 U.S. 503, 521, 522; *United States* v. *Biwabik Mining Co.*, 247 U.S. 116.

Although these cases arose under the Act of 1909,[3] before the enactment of the capital gains provision in the 1921 Act, they established, for purposes of defining "income" in a tax measured by it; that payments by lessees to lessors under mining leases were not a conversion of capital, as upon a sale of capital assets, but were income to the lessor, like payments of rent. And before the 1921 Act this Court had indicated (see *Eisner* v. *Macomber*, 252 U.S. 189, 207), what it later held, that "income," as used in the revenue acts taxing income, adopted since the Sixteenth Amendment, has the same meaning that it had in the Act of 1909. *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U.S. 509, 519; see *Southern Pacific Co.* v. *Lowe*, 247 U.S. 330, 335.

[3] As has been pointed out above, *Stanton* v. *Baltic Mining Co.* arose under the Income Tax Act of 1913.

It therefore follows that the entire amount of the royalty received by the trustees in this case was income in the constitutional sense and that it lay within the power of Congress to tax it in full without the allowance to any one of a deduction on account of depletion.

The taxpayer is therefore claiming a deduction from an item which is admittedly subject to tax as gross income. It is well settled that a taxpayer is not entitled to a deduction as a matter of right and may have only such deductions as are specifically authorized by the statute. *Burnet* v. *Thompson Oil & Gas Co.*, 283 U.S. 301; *Von Baumbach* v. *Sargent*, 242 U.S. 503, *supra; Stanton* v. *Baltic Mining Co.*, 240 U.S. 103. We submit that there is no provision in the Revenue Acts of 1921, 1924 or 1926 which allows a deduction to a taxpayer on account of depletion of a mine leased by a trust of which he is a beneficiary.

## II

### UNDER THE REVENUE ACTS OF 1921, 1924 AND 1926, THE BENEFICIARY OF A TRUST IS NOT ENTITLED TO A DEDUCTION ON ACCOUNT OF THE DEPLETION OF A MINE LEASED BY THE TRUST

The section which relates to the taxability of trusts in the Revenue Acts of 1921, 1924 and 1926 is Section 219 (*infra*, pp. 27–30). This section is substantially the same in each of the three Acts, so far as the present question is concerned. It contains no express provision that a beneficiary of a trust shall be allowed a deduction on account of depletion of trust property; nor do we think that there is any room in Section 219

to imply an intention on the part of Congress that such a deduction should be allowed. As this Court pointed out in *Anderson* v. *Wilson*, 289 U.S. 20, 27, the question is not what a perfectly conceived statute should provide, but what the statute as we find it does provide.

By the terms of the trust in this case "all proceeds which shall come to the hands of the Trustees from said property or from any use which may be made thereof" were directed to be paid to the beneficiaries (R. 90). The trust is therefore one in which all of the current trust income is distributable to the beneficiaries. Section 219 (d) of the Revenue Act of 1921 provides that in such a case "the tax shall not be paid by the fiduciary", but—

> there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not * * *.

The provisions of Section 219 (b) (2) of the Revenue Acts of 1924 and 1926 (*infra*, p. 31) are substantially the same.

It should be noted that the statutes refer to "income", not "net income", and the beneficiary is required to report all income that is actually distributed to him under the trust. Where the trust instrument directs that "all proceeds" shall be distributed to the beneficiaries without providing for the establishment of a reserve for depletion, there is

consequently no authority in Section 219 for permitting the beneficiary to reduce the amount reported on account of depletion of property owned by the trust. The statute makes the beneficiary taxable on his distributive share, and on all of his distributive share. There is no provision that a beneficiary may take a deduction on account of depletion sustained by the trust.

If Congress had intended that the distributive share of a beneficiary should be reduced on account of depletion sustained by the trust, it seems reasonable to suppose that it would have said so. Express provision was made in the statute for other deductions to be made by the beneficiary,[4] and the fact that Congress did not provide for the deduction by a beneficiary on account of depletion sustained by the trust indicates its intention not to allow such a deduction. *Expressio unius est exclusio alterius.*

The claim of the beneficiary for a deduction on account of depletion is not supported, we submit, by Section 214 (a) (10) of the Revenue Act of 1921 (*infra*, pp. 26–27) and Section 214 (a) (9) of the Revenue Acts of 1924 and 1926 which provide for "a reason-

[4] Thus, in Section 219 (d) of the Revenue Act of 1921 and in Section 219 (f) of the Revenue Acts of 1924 and 1926 it is provided that a beneficiary of a trust may deduct from his distributive share for normal tax purposes his proportionate part of the amount received by the trust as dividends, and for all purposes his distributive share of tax exempt interest. And in Section 204 (c) of the Revenue Act of 1921, Section 206 (h) of the Revenue Act of 1924, and Section 206 (g) of the Revenue Act of 1926 it is provided that the benefit of the deduction for net losses shall be allowed to the beneficiaries of a trust.

able allowance for depletion and for depreciation of improvements." This provision appears in the same section of the statute as the provision allowing a deduction for "Losses sustained during the taxable year." Section 214 (a) (5) of the three Acts. The two deductions are obviously *in pari materia*. If Congress did not intend that a beneficiary of a trust should be allowed a deduction for "losses sustained" by the trust it would seem to follow that it did not intend to allow the beneficiary a deduction on account of depletion of the trust property.

In *Anderson* v. *Wilson*, 289 U.S. 20, this Court held that a beneficiary of a trust receiving distributions of the proceeds of sales of property of the trust as well as distributions of income therefrom was not entitled to a deduction for a loss sustained on such a sale. The Court there said (pp. 26–27):

> We hold that the trust, and not the taxpayer, has suffered the loss resulting from the sale of the Commercial Building, and it follows that where loss has not been suffered, there is none to be allowed. Whether the result would be the same if the beneficiaries had been the owner of future estates in remainder, we are not required to determine. Cf. *Francis* v. *Commissioner*, 15 B.T.A. 1332, 1340. Our ruling will be kept within the limits of the case before us. In so ruling we do not forget that the trust is an abstraction, and that the economic pinch is felt by men of flesh and blood. Even so, the law has seen fit to deal with this abstraction for income tax purposes as a separate existence, making its own return

under the hand of the fiduciary and claiming and receiving its own appropriate deductions. The Revenue Act of 1921 under which the tax in question was imposed defines the word "taxpayer" as including a trust or an estate. Revenue Act of 1921, c. 136, 42 Stat. 227, § 2 (9). The definition is pursued to its logical conclusion in a long series of decisions. *Baltzell* v. *Mitchell*, 3 F. (2d) 428; *Whitcomb* v. *Blair*, 58 App.D.C. 104; 25 F. (2d) 528; *Abell* v. *Tait*, 30 F. (2d) 54; *Busch* v. *Commissioner*, 50 F. (2d) 800, 801; *Roxburghe* v. *Burnet*, 61 App.D.C. 141; 58 F. (2d) 693; cf. *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U.S. 509. These and other cases bear witness to the rule that an equitable life tenant may not receive a deduction for the loss of capital assets of the trust, though the result of such a loss is a reduction of his income. The argument will not hold that what was lost to this taxpayer was not the capital of the trust, but rather his own capital, withdrawn from his possession, but held for his account by the executors as custodians or bailiffs. His capital was in the proceeds, to the extent that they were distributed, and never in the land. We do not pause to consider whether a statute differently conceived and framed would yield results more consonant with fairness and reason. We take the statute as we find it.

In this case, as in the *Wilson* case, the beneficiaries of the trust might receive distributions of proceeds of the sale of property constituting the corpus of the

trust as well as distributions of income arising therefrom.[5] We submit that the same principles that prevented the allowance of a deduction for a capital loss to the beneficiary in the *Wilson* case prohibit the allowance of a deduction for depletion in this case.

The two deductions stand on precisely the same footing. The *Wilson* case arose under the Revenue Act of 1921. Section 219 of that Act and Section 219 of the Revenue Acts of 1924 and 1926, all three of which are involved in this case, provide that the income of a trust is to be taxed to the trust as a unit. The trust itself is the taxpayer (Section 2 of the three Acts; *Anderson* v. *Wilson*, *supra*), and is entitled to the same deductions that are allowable to an individual; for Section 219 (b) of the statutes provides that the net income of the trust (with exceptions not here material) shall be computed as that of an individual—that is, the gross income is determined as provided in Section 213, and the trust is entitled to the deductions specified in Section 214.

One of the deductions authorized under Section 214 of the three Acts is for losses in transactions entered into for profit—the deduction at issue in the *Wilson* case. Another deduction authorized under that section is a reasonable allowance for depletion, the

[5] The beneficiaries of this trust were entitled to receive all of the "proceeds" received by the trustees. This would include the right to the proceeds of the sale of the trust corpus, unless at the same time the holders of 51 percent of the beneficial interest in the trust required its termination, in which event the proceeds would go to the Pfister Land Company, the settlor.

deuction involved here. The trust and not the beneficiary is entitled to both deductions.

Section 214 makes no provision for a deduction on account of depletion by the beneficiaries of trusts. It does, however, expressly provide that the allowance for depletion shall be equitably apportioned between lessors and lessees. The fact that Congress provided for depletion in the case of lessees, and made no such provision in the case of trusts, indicates its intention that the deduction on account of depletion is to be taken in its entirety by the "taxpayer" who sustains the depletion, that is, the trust. That this construction was in accord with the understanding of Congress was indicated when, in the Revenue Act of 1928, c. 852, 45 Stat. 791, Congress included in Section 23 (b) a specific provision for the apportionment of depletion between beneficiaries and trustees. In enacting this provision Congress made it plain that it was making a change in the law. In House Report No. 1882, 70th Congress, 1st Session, the relevant portion of which is printed in full in the Appendix (*infra*, p. 34), it is stated (p. 11) that under the law in effect prior to the Revenue Act of 1928

> the deduction, in the case of property held in trust, is allowable only to the trustee.

It has been held in many cases that one taxpayer may not take a deduction properly allowable to another even though the "economic pinch" is ultimately felt by the former. *Anderson* v. *Wilson*, 289 U.S. 20, *supra; Dalton* v. *Bowers*, 287 U.S. 404; *Burnet* v. *Clark*, 287 U.S. 410; *Burnet* v. *Common-*

*wealth Improvement Co.*, 287 U.S. 415; *Nixon* v. *Lucas*, 42 F. (2d) 833 (C.C.A. 2d); *Colston* v. *Burnet*, 59 F. (2d) 867 (App.D.C.), certiorari denied, 287 U.S. 640; *Falk Corp.* v. *Commissioner*, 60 F. (2d) 204 (C.C.A. 7th); *Busch* v. *Commissioner*, 50 F. (2d) 800 (C.C.A. 5th). As this Court pointed out in *Anderson* v. *Wilson*, *supra*, at p. 27, even though the trust is an "abstraction"—

> the law has seen fit to deal with this abstraction for income tax purposes as a separate existence, making its own return under the hand of the fiduciary and claiming and returning its own appropriate deductions.

In reaching its conclusion in *Anderson* v. *Wilson*, *supra*, this Court cited with approval the cases holding that an equitable life tenant may not take a deduction on account of depreciation of the trust property nor on account of a so-called "operating loss" of the trust. The cases cited were *Baltzell* v. *Mitchell*, 3 F. (2d) 428 (C.C.A. 1st), certiorari denied, 268 U.S. 690; *Whitcomb* v. *Blair*, 25 F. (2d) 528 (App. D.C.); *Abell* v. *Tait*, 30 F. (2d) 54 (C.C.A. 4th), certiorari denied, 279 U.S. 849; *Busch* v. *Commissioner*, 50 F. (2d) 800 (C.C.A. 5th); *Roxburghe* v. *Burnet*, 58 F. (2d) 693 (App. D.C.), certiorari denied, 286 U.S. 567. To these cases may be added *Roxburghe* v. *United States*, 64 C. Cls. 223, certiorari denied, 278 U.S. 598; *Codman* v. *Miles*, 28 F. (2d) 823 (C.C.A. 4th), certiorari denied, 278 U.S. 654; *Hubbell* v. *Burnet*, 46 F. (2d) 446 (C.C.A. 8th), certiorari denied, 283 U.S. 840; *Codman* v.

*Commissioner*, 50 F. (2d) 763 (C.C.A. 1st). See also *Commissioner* v. *Freuler*, 62 F. (2d) 733 (C.C.A. 9th) and *Burnet* v. *Whitcomb*, 65 F. (2d) 803 (App. D.C.) now pending before this Court on writs of certiorari, Nos. 129–131 and 139–150, October Term, 1933, which involve the additional question of the effect of a state court decision construing the will.

The respondents argue that Section 214 does not say who shall receive the benefit of the deduction for depletion but provides merely for a reasonable allowance. The same argument might as well be made of the "reasonable allowance" for depreciation which is authorized in the same sentence of the various Acts, but the courts in the cases cited above have recognized that the trust and not the beneficiary is the "taxpayer" who is entitled to the deduction for depreciation. Moreover, it is not specified in Section 214 (a) (5) who shall take the deduction for "losses sustained." Although the beneficiary in *Anderson* v. *Wilson* was the one who felt the "economic pinch," this Court held that the deduction could be taken only by the trust which held the title to the property. Similarly here, the mining property is owned by the trust and not by the beneficiaries and the trust alone is entitled to the deduction.

In *United States* v. *Ludey*, 274 U.S. 295, 303, this Court declared: "In essence, the deduction for depletion does not differ from the deduction for depreciation." We contend that there is no difference in the position of a beneficiary of a trust with regard to depreciation and depletion. In both cases if he is

entitled to receive income undiminished by depreciation or depletion, he is taxable upon that amount. He has never owned the property which is destroyed by depletion or depreciation, and if it does not outlast the trust, it is not his capital which is lost any more than the depreciation in *Weiss* v. *Wiener*, 279 U.S. 333, was a loss to the lessee who had not built the buildings.

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The court below relied on *Lynch* v. *Alworth-Stephens Co.*, 267 U.S. 364, 370, where this Court held that the reasonable allowance for depletion provided by the Revenue Act of 1916 was allowable to a lessee engaged in mining, and stated that the allowance was to be given in case of a mine to everyone whose property right or interest therein has been depleted by the extraction and disposition of the product. But in that case the Court pointed out that the lessee's property interest in the mine consisted in its right to mine and remove the ore and reduce it to possession, and that this property interest (p. 370) "is lessened from year to year as the owner's property interest in the same mines is likewise lessened." But here the beneficiaries of the trust had no direct property interest in the mine. Their right was merely to receive "all proceeds", just as the right of the beneficiaries in *Anderson* v. *Wilson* was (p. 27) "in the proceeds, to the extent that they were distributed, and never in the land." The distinction between the present case and *Lynch* v. *Alworth-Stephens Co.*, *supra*, is emphasized by the decision in *Weiss* v. *Wiener*,

270 U.S. 333, where it was held that a lessee is not entitled to a deduction for depreciation on buildings erected by the lessor, since such buildings do not represent any investment on the part of the lessee. The distinction made between depletion and depreciation, so far as lessees are concerned, is not applicable to beneficiaries of a trust, because the beneficiary does not have any investment in the trust property, but merely a right to receive the "proceeds" after the trustee has dealt with the property in accordance with the terms of the trust.

The respondent also relies upon *Palmer* v. *Bender*, 287 U.S. 551. In that case it was held that a lessee of oil wells who leased them to another, stipulating for a royalty or bonus from the oil to be produced was entitled to an allowance for depletion, whether his conveyance was deemed a sublease or an assignment under the law of the State. But the Court did not hold that everyone receiving income which ultimately was derived from mineral property was entitled to a deduction for depletion. Its decision was based on the ground that the sublessor had an investment in the property and that he must look to the extraction of the oil for a return of his capital. The Court said (p. 557):

> The language of the statute is broad enough to provide, at least, for every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital.

The position of the respondents in this case is wholly different from that of the sublessor in the *Palmer* case. The respondents as beneficiaries had no "investment" in the mineral property. The settlor of the trust interposed a separate entity between the beneficiaries and the ore deposits, and it is that separate entity which has an interest comparable to the lessee in the *Allworth Stephens* case and to that of the sublessor in the *Palmer* case. The position of the beneficiary is more akin to that of a stockholder in a corporation who is taxable on the full amount of the dividends which he receives, and may not deduct a loss which the corporation sustains. *Nixon* v. *Lucas*, 42 F. (2d) 833 (C.C.A. 2d); *Jamison* v. *Edwards*, 2 F. Supp. 302 (S.D.N.Y.); cf. *Dalton* v. *Bowers*, 287 U.S. 404. Conceding the correctness of the respondent's view that the conveyance of an interest in the income of a trust fund may be treated in equity as creating an interest in the fund (*Irwin* v. *Gavit*, 268 U.S. 161) or that such an interest is property (*Bryan* v. *Kennett*, 113 U.S. 179), a beneficiary's interest in the mineral property constituting the corpus of the trust is nevertheless only an equitable interest in the lessor's or lessee's interest in the mine, for the trust itself is the lessor or lessee. Hence the position of the beneficiary is substantially different from that of the lessor or lessee. The beneficiary has no invested capital to recover.

We contend, therefore, that the court below erred in not regarding *Anderson* v. *Wilson*, *supra*, as the controlling authority and also in failing to recognize

the substantial difference between the position of a lessee and a beneficiary of a trust. Because of that distinction neither *Lynch* v. *Alworth-Stephens Co.* nor *Palmer* v. *Bender* is persuasive here. The same errors, we contend, led to the similar decision in *Reynolds* v. *Cooper*, 64 F. (2d) 644 (C.C.A. 10th), now pending on writs of certiorari, Nos. 227-229, October Term, 1933.

Both courts likewise relied upon the decision in *Merle Smith* v. *Commissioner*, 42 F. (2d) 837 (C.C.A. 2d), certiorari denied, 282 U.S. 897. We contend that the *Merle Smith* case is contrary to the decision of this Court in *Anderson* v. *Wilson*, *supra*, since it disregarded the separate entity of trust and beneficiary in allowing deductions for depletion to the trust beneficiary. While that decision rested in part on a supposed distinction between depreciation and capital losses on the one hand, and depletion on the other, the controlling ground appears to have been the fact that in the principal trust involved the beneficiary would receive the corpus of the trust when she reached the age of 45, with power to dispose of it by will before, the trustee being prohibited from selling the property before that time.[8] The respondents argue that their position is very similar

[8] Since denial of the petition for a writ of certiorari in the *Merle-Smith* case, the Commissioner and the Board of Tax Appeals have both allowed deductions for depletion to the beneficiaries of trusts who have a remainder interest in the corpus. *Alphin* v. *Commissioner*, 21 B.T.A. 1101; *Kuhn* v. *Commissioner*, 24 B.T.A. 216; G.C.M. 9804, X-2 Cumulative Bulletin 353; G.C.M. 10273, XI-1 Cumulative Bulletin 169.

to that of the beneficiary in the *Merle-Smith* case for the reason that both the mining lease and the term of the trust extended far beyond the life of the mine, and thus that there will be nothing left of the ore reserves after the termination of the trust.

Upon this premise, the respondents contend that they had a property interest in the ore reserves. We submit that the right of the beneficiaries and the statutory allowance for depletion does not depend upon so variable a factor as the term of the particular trust. There seems to be no basis for saying that a beneficiary under a trust for a short term has no property interest in the ore reserved but that his interest is entirely different where the term of the trust extends beyond the life of the mine. The life of the mine depends upon the extent to which it is worked, and the argument that a beneficiary's right to a depletion allowance depends upon the operating program of those who are actually working the mine seems untenable. The respondent's interest as beneficiaries of the trust was merely a right to receive income. That interest would not change by the exhaustion of the mine, even though the income should stop. The grantor would still be the remainderman; the respondents' interest in the property does not depend upon the value which remains when the property is to be reconveyed.

The case of *Commissioner* v. *Molter*, 60 F. (2d) 498 (C.C.A. 10th), is similarly distinguishable. The court there held that where a husband and wife jointly invested their earnings in certain land, taking

title in the name of the husband, the wife was entitled to part of the depletion allowance with respect to oil wells discovered on the land. But the wife there could compel conveyance of title; she was in substance a part owner of the property. She had made an investment in the land itself and was accordingly entitled to a deduction on account of the depletion sustained with respect to that investment. The respondents here were neither owners, lessors nor lessees of the mine, and they had no investment in it and no interest in it beyond the right to receive income. They were entitled to receive and did receive distributions of trust income undiminished by deductions for depletion. We submit that they are not entitled to the deductions claimed.

## CONCLUSION

The decision of the Circuit Court of Appeals is erroneous and should be reversed.

Respectfully submitted.

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NOVEMBER 1933.

## APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227, 239, 242, 246:

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * *

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further*, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter: *And Provided further*, That such depletion allowance based on discovery value shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made, except where such net income so computed is less than the depletion allowance based on cost or fair market value as of March 1, 1913; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary.

In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee; * * *.

SEC. 215. (b) Amounts paid under the laws of any State, Territory, District of Columbia, possession of the United States, or foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time, nor by any deduction allowed by this Act for the purpose of computing the net income of an estate or trust but not allowed under the laws of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holder is entitled.

SEC. 219. (a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including

(1) Income received by estates of deceased persons during the period of administration or settlement of the estate;

(2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;

(3) Income held for future distribution under the terms of the will or trust; and

(4) Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as pro-

vided in section 212, except that (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of section 214) there shall also be allowed as a deduction, without limitation, any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in paragraph (11) of subdivision (a) of section 214. In cases in which there is any income of the class described in paragraph (4) of subdivision (a) of this section the fiduciary shall include in the return a statement of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable to to each beneficiary, whether or not distributed before the close of the taxable year for which the return is made.

(c) In cases under paragraphs (1), (2), or (3) of subdivision (a) or in any other case within subdivision (a) of this section except paragraph (4) thereof the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir, or other beneficiary. In such cases the estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216.

(d) In cases under paragraph (4) of subdivision (a), and in the case of any income of an estate during the period of administration or settlement permitted by subdivision (c) to be deducted from the net income upon which tax is to be paid by the fiduciary, the tax shall not be paid by the fiduciary,

but there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not, or, if his taxable year is different from that of the estate or trust, then there shall be included in computing his net income his distributive share of the income of the estate or trust for its taxable year ending within the taxable year of the beneficiary. In such cases the beneficiary shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the estate or trust.

(e) In the case of an estate or trust the income of which consists both of income of the class described in paragraph (4) of subdivision (a) of this section and other income, the net income of the estate or trust shall be computed and a return thereof made by the fiduciary in accordance with subdivision (b) and the tax shall be imposed, and shall be paid by the fiduciary in accordance with subdivision (c), except that there shall be allowed as an additional deduction in computing the net income of the estate or trust that part of its income of the class described in paragraph (4) of subdivision (a) which, pursuant to the instrument or order governing the distribution, is distributable during its taxable year to the beneficiaries. In cases under this subdivision there shall be included, as provided in subdivision (d) of this section, in computing the net income of each beneficiary, that part of the income of the estate or trust which, pursuant to the instrument or order governing the

distribution, is distributable during the taxable year to such beneficiary.

Revenue Act of 1924, c. 234, 43 Stat. 253, 269, 272, 275:

SEC. 214. (a) In computing net income there shall be allowed as deductions:

* * * * *

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee; * * *. (U.S.C., Title 26, Sec. 955.)

SEC. 215. (b) Amounts paid under the laws of any State, Territory, District of Columbia, possession of the United States, or foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time, nor by any deduction allowed by this Act for the purpose of computing the net income of an estate or trust but not allowed under the laws of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holder is entitled. (U.S.C., Title 26, Sec. 956.)

SEC. 219. (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that—

* * * * *

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) in the same or any succeeding taxable year;

* * *

* * * * *

(c) For the purpose of the normal tax the estate or trust shall be allowed the same credit as is allowed to a single person under subdivision (c) of section 216, and, if no part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, then in addition the same credits as are allowed by subdivisions (a) and (b) of section 216.

(d) If any part of the income of an estate or trust is included in computing the net income of any legatee, heir, or beneficiary, such legatee, heir, or beneficiary, shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are, under this section, required to be included in computing his net income. Any remaining portion of such amounts specified in subdivisions (a) and (b) of section 216 shall, for the purpose of the normal tax, be allowed as credits to the estate or trust.

(e) If the taxable year of a beneficiary is different from that of the estate or trust, the amount which he is required, under paragraph (2) of subdivision (b) of this section, to include in computing his net income, shall be based upon the income of the estate or trust for its taxable year ending within his taxable year. (U.S.C., Title 26, Sec. 960.)

Revenue Act of 1926, c. 27, 44 Stat. 9, 26, 28, 32: Sections 214 (a) (9) (U.S.C. App., Title 26, Sec. 955), 215 (b) (U.S.C. App., Title 26, Sec. 956), and 219 (U.S.C. App., Title 26, Sec. 960), are identical with those above quoted.

Treasury Regulations 65:

ART. 294. *Life or terminable interests.*—Amounts paid to the holder of a life or termi-

nable interest acquired by gift, bequest, or inheritance shall not be subject to any deduction for shrinkage (whether called depreciation or any other name) in the value of such interest due to the lapse of time. In other words, the holder of such an interest so acquired may not set up the value of the expected future payments as corpus or principal and claim deductions for shrinkage or exhaustion thereof due to the passage of time.

No deduction shall be allowed in the case of a life or terminable interest acquired by gift, bequest, or inheritance, where the estate or trust is entitled to a deduction under the statute but there is no reduction of the income of the life or terminable interest. For example, an estate or a trust in a certain State sells securities at a loss; if, under the laws of that State, the beneficiary suffers no actual loss, then even though the estate or trust is permitted to deduct such loss in making its return, the beneficiary whose income has not been diminished thereby is not entitled to a deduction on account of such loss, but must include in his return the full amount distributed or distributable. See articles 341-347.

ART. 341. *Estates and trusts.*—In general, the income of a trust for the taxable year which is to be distributed to the beneficiaries must be returned by and will be taxed to the respective beneficiaries, but the income of a trust which is to be accumulated or held for future distribution, whether consisting of ordinary income or gain from the sale of assets included in the corpus of the trust, must be returned by and will be taxed to the trustee. The exception to this general rule is with respect to the income of a trust revocable by the grantor, and the income of a trust which may be distributed to the grantor or used to pay

the premiums upon policies of insurance on his life, which income, whether or not distributed, must be returned by and will be taxed to the grantor of the trust. (See article 347.)

See section 225 and articles 421 and 423 with reference to fiduciary returns, and article 294 with reference to deductions.

Treasury Regulations 69:

Articles 294 and 341 of Regulations 69 are substantially the same as those above quoted.

CONGRESSIONAL COMMITTEE REPORT

In the Conference Report on the Revenue Bill of 1928 (House Report No. 1882, 70th Congress, 1st Session) the following statement is made (pp. 11–12):

Amendment No. 30: Under existing law difficulty has been experienced in determining and allowing the deduction for depreciation in cases where property is held by one person for life with remainder to another person; and the deduction, in the case of property held in trust, is allowable only to the trustee. The Senate amendment provides that a life tenant, for the purpose of this deduction, shall be considered as the absolute owner; so that he will be entitled to the deduction during his life, and that thereafter the deduction, if any, will be allowed to the remainder man. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is allocable to the trustee and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named

beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee. The bill contains similar provisions as to the deduction for depletion. The Senate amendment provides for an equitable apportionment of the deduction in these cases; and the House recedes.

U. S. GOVERNMENT PRINTING OFFICE: 1933

# In the Supreme Court of the United States

OCTOBER TERM, 1933

---

No. 225

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner,

*v.*

OTTO H. FALK ET AL., EXECUTORS OF THE ESTATE OF Charles F. Pfister, Deceased

---

*ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT*

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**MEMORANDUM FOR THE PETITIONER**

In further support of the argument that the beneficiaries of the trust involved in this case are not entitled to deductions on account of depletion of the trust property, the petitioner desires to call attention to a statute of Michigan, which seems pertinent. The lands held by the trust in this case, including that upon which the mine in question was located, were situated in Michigan. (R. 82–87.) At all times since 1857, and continuing until the present, there has been in force in Michigan a stat-

ute containing the following provisions (Michigan Compiled Laws (1929), Sec. 12982):

> Every express trust, valid as such in its creation, except as herein otherwise provided, shall vest the whole estate in the trustees, in law and in equity, subject only to the execution of the trust; and the person for whose benefit the trust was created shall take no estate or interest in the lands, but may enforce the performance of the trust in equity.

Our argument that the depletion in this case was suffered by the trust and not by the beneficiaries is directly supported by this statute, we submit, since under its provisions the creation of the trust vested "the whole estate in the trustees, in law and in equity", and the beneficiaries of the trust took "no estate or interest in the lands." Cf. *Archer-Shee* v. *Garland*, [1931] A.C. 212, which involved the nature of the interest of a beneficiary under a similar New York statute.

Respectfully submitted.

J. CRAWFORD BIGGS,
*Solicitor General.*
ERWIN N. GRISWOLD,
*Special Assistant to the Attorney General.*

DECEMBER 1933.

U. S. GOVERNMENT PRINTING OFFICE: 1933.

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# In the Supreme Court of the United States

OCTOBER TERM, 1933.

No. 225

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DAVID BURNET, Commissioner of Internal Revenue,

Petitioner,

vs.

OTTO H. FALK, et al., Executors of the Estate of Charles F. Pfister, Deceased.

---

On Petition for a Writ of Certiorari to The United States Circuit Court of Appeals for the Seventh Circuit.

---

## BRIEF FOR THE RESPONDENTS IN OPPOSITION.

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# In the Supreme Court of the United States

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DAVID BURNET, Commissioner of Internal Revenue,

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OTTO H. FALK, et al., Executors of the Estate of Charles F. Pfister, Deceased.

---

**On Petition for a Writ of Certiorari to The United States Circuit Court of Appeals for the Seventh Circuit.**

---

## BRIEF FOR THE RESPONDENTS IN OPPOSITION.

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### Statement.

To the facts stated in the petition the following, taken from the stipulated facts should be added:

After providing for the payment of taxes and necessary expenses incident to administration, including compensation for the trustee, the trust deed provided:

Except as above authorized to be expended, paid out or retained, all proceeds which shall come to the hands of the Trustees from said property or from any use which may be made thereof, or from any source whatsoever hereunder, as received by the Trustee *shall belong to and be the property of the beneficiaries hereunder* to be distributed and paid over to them in proportion to and in accordance with their respective interests as shown herein (R. 98, 99, 100).

If *as matter of law* the beneficiaries of the trust are entitled to an allowance for depletion, it was stipulated that the life of the mine for the purposes of the determination of the amount of the allowance was nine years from the basic date, November 29, 1916, and the amount of the allowance $.13255 per ton of ore mined (R. 99, 100).

The mining lease extended for a period exceeding the life of the mine as fixed for the purposes of depletion allowances, and the term of the trust exceeded the term of the lease and the life of the mine.

## Question Involved.

The petition states that the question presented is,

> "Whether the beneficiaries of a trust who have no interest in the trust corpus are entitled to a deduction for depletion of a mineral property constituting the corpus of the trust."

If that is the question intended to be presented by the petition, it is not the question presented by the facts of the case or upon which the decision of the Court below was based. Upon the facts presented the Court below held that the beneficiaries of the trust did have such an interest in the trust corpus as entitled them to deductions for depletion under the statute. *64 Fed. (2) 171, 172.*

## Argument.

### Under the peculiar conditions in this case the beneficiaries of the trust are clearly within the terms and implications of the statute requiring deductions for depletion.

Section 214 (a) of the Statutes, 1921, 1924 and 1926 Acts, provides that in computing net income there shall be allowed as deductions "* * * (10) In the case of mines * * * a reasonable allowance for depletion * * * according to the peculiar conditions in each case * * *"

It is argued in the brief for petitioner that because these provisions do not specify beneficiaries of trusts as entitled to the deduction they are excluded from the allowance. But they do not specify *who is entitled to the deductions.* The necessary implication is that all who are subject to the tax on the proceeds of the mining operation that results in the exhaustion of the ore reserve from which the proceeds are derived are entitled to the deduction in accordance with their respective interests. The trustees in this case are in the position of the lessors of the mine. They cannot take the deduction that pertains to the interest of the owner of the ore reserve, because they are not subject to the tax upon the royalties. By the express terms of the trust instrument all property rights in the royalties less necessary expenses of administering the trust pass to the beneficiaries coincident with their receipt by the trustees who are required to distribute them accordingly as and when they are received. With respect to the royalties which are the subject of the tax and from which the deduction for depletion on account of the owners' interest in the ore reserve must be taken, the trustees act merely as dis-

tributing agents. If the beneficiaries who receive them at the hands of the trustees and are subject to the tax are not entitled to deductions for depletion then there can be no deduction on account of the depletion of the owner's interest in the ore reserve by the operations under the lease. The statute does not permit of any such unreasonable construction.

The provision of the 1928 Act, sec. 23 (1), impliedly refutes the contention of the petitioner that the corresponding provision of previous Acts excluded beneficiaries under trusts from the allowance. The provision of the 1928 Act reads as follows:

> "In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each."

It will be noted that the first sentence of this section which grants the right to an allowance for depletion is the same as in previous Acts. What follows presupposes the application of the first sentence to the cases specified and provides how the allowance shall be apportioned in those

cases. The provisions referring to the specified cases are administrative only, making clear for purposes of administration that would otherwise be left to construction. The view of Judge Manton in the *Merle-Smith* case that this section was declaratory of the law as it already existed in prior enactments (*42 Fed. (2)* p. 842), was obviously correct.

## II.

## The question sought to be raised by the petition is foreclosed by decisions of this court.

*Lynch vs. Alworth-Stephens Co.*, 267 U. S. 364; *U. S. vs. Ludey*, 274 U. S. 295; *Bryant vs. Kennett*, 113 U. S. 179; *Croxall vs. Sheperd*, 5 Wall. 268; *Irwin vs. Gavit*, 268 U. S. 161; *Merle-Smith vs. Com'r of Internal Revenue*, 42 F. (2) 837, certiorari denied by this court, 282 U. S. 897; *Palmer vs. Bender*, 53 S. C. 225, decided January 9, 1933; *Bankers Pocahontas Coal Company vs. Burnet*, 53 S. C. 150, decided Dec. 5, 1932.

In *Palmer vs. Bender*, 53 S. C. 225, decided January 9, 1933, the court said:

> "That the allowance for depletion is not made dependent upon the particular legal form of the taxpayer's interest in the property to be depleted was recognized by this Court in Lynch vs. Alworth-Stephens Co., 267 U. S. 364, 45 S. Ct. 274, 69 L. Ed. 660. There a depletion allowance under section 12(a) of the 1916 act, 39 Stat. 767, was claimed by a lessee of a mining lease, in the computation of tax on income from the proceeds of ore mined. *The statute made no specific reference to lessees,* and the government argued that, as the lessee acquired no ownership of the ore until the severance from the soil (see United States vs. Biwabik Mining Co., 247 U. S. 116, 123, 38 S. Ct. 462, 62 L. Ed. 1017) the

lease gave him no depletable interest in the ore in place. But this Court held that regardless of the technical ownership of the ore before severance, the taxpayer, by his lease, had acquired legal control of a valuable economic interest in the ore capable of realization as gross income by the exercise of his mining rights under the lease. Depletion was therefore allowed.

"Similarly, the lessor's right to a depletion allowance does not depend upon his retention of ownership or any other particular form of legal interest in the mineral content of the land. It is enough if by virtue of the leasing transaction he has retained a right to share in the oil produced. If so, he has an economic interest in the oil, in place, which is depleted by production. Thus we have recently held that the lessor is entitled to a depletion allowance on bonus and royalties, although by the local law ownership of the minerals in place passed from the lessor upon the execution of the lease. See Burnet vs. Harmel, supra; Bankers' Pocahontas Coal Company vs. Burnet, 287 U. S. , 53 S. Ct. 150, 77 L. Ed. , decided December 5, 1932." (pp. 226 and 227.) (Italics ours.)

In *Irwin vs. Gavit*, 268 U. S. 161, 167, it was said:

"A gift of the income of a fund ordinarily is treated by equity as creating an interest in the fund. Apart from technicalities, we can perceive no distinction relevant to the question before us between a gift of the fund for life and a gift of the income from it."

*A fortiori* the right to receive a portion of the proceeds from the removal and sale of ore in place in a mine gives to the recipient an interest in the ore reserve, regardless of how the legal title to the ore reserve may be held.

"In the consideration of a court of equity, the *cestui que trust* is actually seized of the freehold. He may alien it, and any legal conveyance by him will have the same operation in equity upon the trust, as it would have had at law upon the legal estate.

The trust like the legal estate is descendible, devisable, alienable, and barrable by the act of the parties, and by matter of record. Generally, whatever is true at law of the legal estate, is true in equity of the trust estate."

*Croxall vs. Shepard*, 5 Wall. 268, 281.

In *Bryan vs. Kennett*, 113 U. S. 179, the Court said:

"The term 'property' as applies to lands, comprehends every species of title, inchoate or complete." * * * By the term 'property' applied to lands all titles are embraced, legal or equitable, perfect or imperfect."

In *Lynch vs. Alworth Stephens Co.*, 267 U. S. 364, the Court said:

"There is nothing [in the Revenue Act] to suggest that the word 'property' is used in any restricted sense * * *."

"The plain, clear and reasonable meaning of the statute seems to be that the reasonable allowance for depletion in case of a mine is to be made to every one whose property right and interest therein has been depleted by the extraction and disposition 'of the product thereof which has been mined and sold during the year for which the return and computation are made.' And the plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover"

"It is said that the depletion allowance applies to the physical exhaustion of the ore deposits, and since the title thereto is in the lessor, he alone is entitled to make the deduction. But the fallacy in the syllogism is plain. The deduction for depletion in the case of mines is a special application of the general rule of the statute allowing a deduction for exhaustion of property. While respondent does not own the ore deposits, its right to mine and remove the ore and reduce it to possession and own-

> ership is property within the meaning of the general provision. Obviously, as the process goes on, this property interest of the lessee in the mines is lessened from year to year, as the owner's property interest in the same mines is likewise lessened. There is an exhaustion of property in the one case as in the other; and the extent of it, with the consequent deduction to be made, in each case is to be arrived at in the same way, namely, by determining the aggregate amount of the depletion of the mines in which the several interests inhere, based upon the market value of the product, and allocating that amount in proportion to the interest of each severally considered" (p. 370).

In the language of Judge Manton in the *Merle Smith* case, the beneficiaries *in the instant cases*,

> "have a property right and interest, within the decision of Bryan vs. Kennet, 113 U. S. 179, 5 S. Ct. 407, 28 L. Ed. 908, as real as that of the lessee referred to in Lynch vs. Alworth-Stephens Co., supra." (*42 Fed. (2)* at p. 840.)

The *Merle-Smith* case was not decided on the ground of the remainder interests involved but on the ground that it was the intention of Congress to exempt from the tax in the determination of taxable income the portion of the proceeds of the mining operation which may be regarded as a return of capital (*42 Fed. (2)* at pp. 840-842). The decision of the case on that ground is amply supported by the decisions of this Court.

Thus in *U. S. vs. Lidey*, 274 U. S. 295, 303, the court said:

> "The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any year represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material

in making the product of a manufacturing establishment. As the cost of the raw material must be deducted from the gross income before the net income can be determined, so the estimated cost of the part of the reserved used up is allowed."

* * * * *

"The Corporation Tax Law of 1909 (36 Stat. 112) had failed to provide for any deduction on account of the depletion of mineral reserves. Stratton's Independence vs. Howbert, 231 U. S. 399, 34 S. Ct. 136, 58 L. Ed. 285; Von Baumbach vs. Sargent Land Co., 242 U. S. 503, 37 S. Ct. 201, 61 L. Ed. 460; United States vs. Biwabik Mining Co., 247 U. S. 116, 38 S. Ct. 462, 62 L. Ed. 1017; Goldfield Consolidated Mines Co. vs. Scott, 247 U. S. 126, 38 S. Ct. 465, 62 L. Ed. 1022. The resulting hardship to operators of mines induced Congress to make provision in the Revenue Law of 1913 (38 Stat. 114, 167) and all later acts for some deduction on account of depletion in determining the amount of the taxable income from mines."

In *Bankers Pocahontas Coal Co. vs. Burnet*, 53 S. Ct. 150, decided December 5, 1932, referring to the facts of that case, this court said:

"The applicable statutes thus construed and applied do not tax any part of petitioner's capital investment before March 1, 1913. Section 234 (a) (9) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077, and regulations under it, require depletion allowances upon bonus and royalty payments received by the lessor of mineral lands, *sufficient to provide for a return in full of his invested capital*" (pp. 150, 151) (Italics ours).

The decisions of all of the other lower courts in which the question was involved are in accord with the decision of the court below in this case.

*Merle-Smith vs. Com'r of Int. Revenue*, 42 F. (2) 837.

*Com'r of Int. Revenue vs. Molter*, 60 F. (2) 498.

*Cooper vs. Reynolds*, 60 F. (2) 650.

Assuming that the remainder interests involved, were the decisive factor in the decision of the Court of Appeals in the *Merle-Smith* case, that does not alter the effect of the denial by this court of *certiorari*, as a controlling precedent in this case. Upon the facts stipulated in this case no remainder interest in the ore reserve is involved. It was stipulated that the life of the mine was nine years from November 29, 1946 (Rec. 99). The term of the mining lease exceeded the life of the mine and the term of the trust exceeded that of the mining lease. On the hypothesis upon which the allowance for depletion was computed there would be no remainder interest in the ore reserve after the expiration of the lease and the term of the trust.

It is said in the brief for petitioner that it was not shown that the mineral body was in fact exhausted before the lease expired (p. 14). But the term of the lease was for upwards of 14 years from November 29, 1916, extending at least four years beyond the last of the years here involved (1926). It cannot be assumed that the mineral body would not be exhausted within the term of the lease which was upwards of 14 years, when it was stipulated for the purposes of the depletion allowance that the life of the mine was only nine years. The question of the remainder interest is, however, wholly immaterial in any event. If a possible remainder interest can defeat the right of the beneficiaries to depletion in this case, it should have defeated the right of the lessee to claim depletion in the *Allworth Stephens Co.* case in which this court held that the lessee was entitled to the deduction. All that is said by counsel for petitioner as to the possibility of the ore reserve not being exhausted during the term of the lease in this case is equally applicable to the *Allworth-Stephens Co.* case which was decided contrary to the petitioner's contentions here.

## III.

### The cases relied on by petitioner are without application.

*Anderson vs. Wilson*, 289 U. S. 20, did not involve the application of the statute providing for depletion and is plainly inapplicable. The other cases relied on in petitioner's brief relate to ordinary depreciation and likewise did not involve the construction or application of the statute relating to depletion as distinguished from ordinary depreciation. Their lack of application is shown by what is said in the *Merle Smith* case with reference to *Harburghe vs. U. S.*, 64 Ct. Cls. 223, one of the cases relied on by petitioner. As said by Judge Manton with reference to that case:

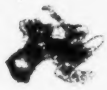
> "* * * the plaintiff was merely a beneficiary entitled only to income of the trust created for her life. She had no interest in the corpus. The distribution to be made to her from the trust included nothing which could be considered as a part of the corpus. The taxpayer claimed a right to deduct the allowance provided by the act for the depreciation of the properties constituting the corpus of the trust. The difference between that case and the one at bar is that the intention of Congress as to depletion seems to be clear by the act. There is a direction in this trust to distribute to the petitioners not only income from the mining properties, but also a portion of what Congress has considered part of the capital, a part of the corpus of the trust" (*42 Fed. (2)* at pp. 841-842).

In the instant case, the trustees not being chargeable with the tax upon the royalties and having no authority to set aside any portion thereof for a depletion reserve, could not take the deductions for depletion. In their fiduciary returns they made claim for depletion at the proper

rates for the benefit of the beneficiaries, the taxpayers. They could do no more. If they had been entitled under the terms of the trust conveyance to withhold a reserve for depletion, the distribution of this reserve, obviously would not have been taxable income. No more was it when it was distributed to the beneficiaries of the trust currently as it was received as required by the trust instrument.

In conclusion it is respectfully submitted that the question presented by the petition is not an open question under the decisions of this court, and as there is no division in the decisions of the lower courts upon the question there is no reason for a writ of certiorari.

CHARLES F. FAWSETT,
R. S. DOYLE,
Counsel for Respondent.



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No. 285

# In the Supreme Court of the United States

OCTOBER TERM, 1933

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

vs.

OTTO H. FALK, et al., Executors of the Estate of
Charles F. Pfister, Deceased.
Respondents.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

## BRIEF FOR THE RESPONDENTS.

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Milwaukee, Wis.

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# In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 225

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GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

vs.

OTTO H. FALK, et al., Executors of the Estate of
Charles F. Pfister, Deceased.
Respondents.

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**On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.**

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## BRIEF FOR THE RESPONDENTS.

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### Statement.

All that needs to be added to the statement of facts in the brief for petitioner is that by the terms of the stip-

ulation filed at the hearing before the Board of Tax Appeals the life of the mine for the purpose of depletion allowances was nine years (R. 81).

## The Question Involved.

The question involved in the case may be broadly stated as follows:

Whether in a case of a mine held in trust where the net proceeds of mining and selling the ore is distributed currently to the beneficiaries of the trust, the allowance for depletion made by the statute inures to the benefit of the beneficiaries as the taxpayers and the real parties in interest. That the mine was operated under a lease in which the trustees were the lessors and from which they received royalties as the share of the fee owner in the proceeds of the operation, does not narrow or alter the question.

It is contended by the petitioner that the entire proceeds from the working of a mine are income in the constitutional sense and may be subjected to taxation without allowance for depletion. That contention may be set aside, as the Revenue Acts beginning with the Act of 1913 have provided that in computing taxable income in the case of mines there shall be allowed a proper deduction for depletion. But it is claimed by the petitioner that in the case of a mine that is held in trust, the allowance is only to the fiduciary. In this case the fiduciaries made claim for the allowances made by the statute. It is conceded that for the calendar years 1922 to 1926, inclusive (the years here involved), the trustees made fiduciary returns in which they claimed deductions for depletion based upon a depletion rate of 13.255 cents per ton and that the Commissioner disallowed the deductions and

increased the distributive share of each beneficiary by a proportionate amount of the depletion deductions claimed, and that the amounts claimed were the proper allowances if depletion is allowable (P. Br. pp. 5, 6).

The contention of the petitioner is that under the terms of section 219 of the Revenue Acts 1921, 1924 and 1926 relating to trusts, the allowance is only to the fiduciary and must be included in the taxable income of the beneficiaries. The material provisions of that section, taken from the 1924 and 1926 Act, are as follows:

> Sec. 219 (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including:
>
> (1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;
>
> (2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;
>
> * * * * *
>
> (4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.
>
> (b) * * * the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary.
>
> The net income of the estate or trust shall be computed in the same manner and on the

same basis as provided in section 212, except that:

* * * * *

(2). There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries,

* * * * *

but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not.

Section 212 referred to as the basis for determining the *taxable income of the trust estate*, defines net (taxable) income, as "the gross income as defined in section 213 less the deductions allowed by sections 214 and 206."

One of the deductions allowed by section 214 in the case of mines is "a reasonable allowance for depletion" [214 (a) (9)].

It is not denied by the petitioner that this deduction is allowed in computing *the net income of the trust estate.* But it is contended that the benefit of the deduction is denied to the beneficiaries by *par. (2) of subdivision (b)* of section 219 which provides that, "there shall be allowed as an *additional deduction* in computing the net income of the estate or trust *the amount of the income* of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiares, * * * but the amount so allowed as a deduction shall be

included in computing the net income of the beneficiaries whether distributed to them or not."

*It is the position of the respondent that such a construction of the statute is not required by is terms and is without support in reason.*

## Summary of Argument.

It is the manifest purpose of section 219 to impose the tax *on the net income of the trust estate* which is the gross income as defined in section 213, less the deductions specifically allowed in sections 206 and 214, one of which, in the case of mines, is a reasonable allowance for depletion. To the extent that the *taxable income* is to be accumulated and held by the trustees for future distribution, the tax is required to be paid by the fiduciary. To the extent that it is required to be distributed currently to the beneficiaries, the tax is imposed upon them and the income of the trust upon which the beneficiaries are required to pay the tax is allowed to the trustee as *an additional deduction.* This is merely a method of imposing the tax on the taxable income of the trust *directly* upon the beneficiaries to the extent that it is distributable to them currently, instead of *indirectly* by imposing it upon the trustee. In either case the tax is in reality paid by the beneficiaries, as if it were paid by the trustee it would be charged against the income currently distributable to the beneficiaries. The deductions *specifically allowed in sections 206 and 214* in determining the taxable income of the trust estate, are exempted from the tax and are not included by the terms of section 219 in the *additional deduction* allowed the trustee which is required to be included by the beneficiaries in their returns as a part of their taxable income. In the construction of the stat-

ute it is of no importance that the deductions allowed in the determination of the taxable income of the trust estate may be allowed nominally to the trustee. They are, however, allowed to the *trust estate* and not specifically to the trustee. The obvious purpose of the allowance is to exempt the amounts thereof from the tax and unless the exemptions inure to the benefit of those upon whom the tax upon the net income of the estate is really imposed, the deductions are meaningless. Where the entire net income of the trust estate computed as provided in section 212, is currently distributable to the beneficiaries, they are the taxpayers and the real parties in interest. Even if the deductions specified in sections 206 and 214 which are allowed the trust estate, were included by the literal terms of section 219 in the taxable income of the beneficiaries, they would be excluded by construction.

## ARGUMENT.

### I.

**It is of no importance that the allowance for depletion made by the statute in the case of mines is not made specifically to beneficiaries of trusts.**

Deductions allowed by section 219 in computing the net income of the trust estate are allowed to the *trust estate*, which includes the interests of the beneficiaries and the deductions must be deemed to inure to the benefit of the parties in interest, which is to say those who are called upon to pay the tax upon the income of the trust estate. If it may be considered that under the terms of the statute the deductions are nominally allowed to the trustee, this is of no importance, as the trustee is the representative of the beneficiaries of the trust.

### II.

**By the terms of section 219 and the sections to which it refers, the allowance for depletion applies to all cases of mines. To deny the benefit of the allowance to the beneficiaries in the case of a mine held in trust where the proceeds of its operation are distributable to the beneficiaries, is to make an exception to the application of the statute not warranted by its terms.**

The contention of the petitioner would in effect deny allowance for depletion *in the case of all mines held in trust* where the net proceeds which come to the hands of the trustee are distributable currently to the beneficiaries. To allow depletion to the trustee but deny the

benefit of the allowance to the beneficiaries of the trust in such cases, would be but illusory and an idle gesture. It is the beneficiary who pays the tax. No such inanity can be read into the statute.

*The construction of the statute contended for by the petitioner is not required by its terms.*

1. What is to be included in computing the net income of the beneficiaries by the terms of par. (2) of subdivision (b) of section 219, is not any of the deductions that are allowed in section 214, but an "*additional deduction*" described as the amount of the *income* of the trust estate for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries. The "additional deduction" cannot include anything previously allowed as a deduction. That would not be an *additional* allowance but a second allowance of something already allowed and consequently meaningless. The *amount* of the "*additional deduction*" referred to which must be included in computing the *net income* of the beneficiaries is *ex vi termini*, limited by the previous deductions to which the addition refers.

2. The additional deduction referred to is in terms *income*. It is the *amount of the income* of the trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries. The amount allowed for depletion is allowed, not *as income*, but *as a return of capital*.

*U. S. vs. Ludey*, 274 U. S. 295, 303.

Conceding that the entire proceeds of a mining operation may be treated by Congress as income for the purposes of the tax, Congress has not so elected in the Reve-

nue Acts, beginning with the Act of 1913. As said by this Court in *U. S. vs. Ludley*, 274 U. S. 295, 302, 303:

> "The Corporation Tax Law of 1909 (36 Stat. 112) had failed to provide for any deduction on account of the depletion of mineral reserves. *Stratton's Independence vs. Howbert*, 231 U. S. 399, 34 S. Ct. 136, 58 L. Ed. 285; *Von Baumbach vs. Sargent Land Co.*, 242 U. S. 503, 37 S. Ct. 201, 61 L. Ed. 460; *United States vs. Biwabik Mining Co.*, 247 U. S. 116, 38 S. Ct. 462, 62 L. Ed. 1017; *Goldfield Consolidated Mines Co. vs. Scott*, 247 U. S. 126, 38 S. Ct. 465, 62 L. Ed. 1022. The resulting hardship to operators of mines induced Congress to make provision in the Revenue Law of 1913 (38 Stat. 114, 167) and all later acts for some deduction on account of depletion in determining the amount of the taxable income from mines. * * * The proviso limiting the amount of the deduction for depletion to the amount of the capital invested *shows that the deduction is to be regarded as a return of capital* * * *." (Italics ours.)

And in *Bankers Pocahontas Coal Co. vs. Burnet*, 53 S. Ct. 150, 151, referring to the facts of that case the court said:

> "The applicable statutes thus construed and applied do not tax any part of petitioner's capital investment before March 1, 1913. Section 234 (a) (9) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077, and regulations under it, require depletion allowances upon bonus and royalty payments received by the lessor of mineral lands, *sufficient to provide for a return in full of his invested capital*" (pp. 150, 151) (Italics ours).

That the allowance for depletion which has its basis in the value of the ore in place in the mine before it is mined, is in reality capital and not income, was clearly recognized by this court in *U. S. vs. Ludey*, wherein it was said:

> "The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any year represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material in making the product of a manufacturing establishment. As the cost of the raw material must be deducted from the gross income before the net income can be determined, so the estimated cost of the part of the reserve used up is allowed. The fact that the reserve is hidden from sight presents difficulties in making an estimate of the amount of the deposits. The actual quantity can rarely be measured. It must be approximated. And because the quantity originally in the reserve is not actually known the percentage of the whole withdrawn in any year, and hence the appropriate depletion charge, is necessarily a rough estimate. But Congress concluded, in the light of experience, that it was better to act upon a rough estimate than to ignore the fact of depletion" (p. 302).

Reading into the statute the construction placed by this Court upon the meaning and intent of the allowance made for depletion, the amount allowed for depletion is not allowed as income, but as the element of capital in-

cluded in the proceeds of a mining operation. While the entire proceeds of a mining operation may be included in the term gross income as used in section 213, it was recognized by Congress as held by this Court that in fairness a deduction *should be allowed* for what is *in reality* not strictly income but capital, and the allowance for depletion was made as a return of capital (*U. S. vs. Ludey*, 205 U. S. 302, 303). The allowance for depletion which was claimed both by the trustees and the beneficiaries in this case, was thus given by Congress the character of capital or *part of the corpus of the trust estate* in the hands of the trustees before it was distributed to the beneficiaries. It did not lose that character by the fact of its distribution, and become income in the hands of the beneficiaries.

It is said that the beneficiaries of a trust are not allowed the benefit of deductions from income for *depreciation* of the corpus and reference is made to the statement in the opinion in *U. S. vs. Ludey* that "in essence the deduction for depletion does not differ from the deduction for depreciation." That was manifestly true for the purposes of the question involved in that case. But a distinction between the two was drawn by the court in *Lynch vs. Alworth-Stephens Co.* 267 U. S. 364, and in *Von Baumbach vs. Sargent Land Co.*, 242 U. S. 503, upon the facts of those cases. It is the established rule that statements in an opinion of the court are made with reference to the facts in the particular case and are limited thereby. We are dealing here with the question of depletion which is specially provided for in the statute, distinct from the deduction allowed for depreciation. It may be conceded that where the beneficiary under a trust is entitled only to income with no interest in the corpus, and is entitled to receive nothing that could be considered

as part of the corpus, he is not entitled to take a deduction in his income tax return for mere depreciation of the corpus in the sense in which the term depreciation is used in the statutes as held by this court in the two cases last above cited. But in the language of the Court of Appeals in *Merle-Smith, ex. Commissioner of Internal Revenue*, 42 Fed. (2d) 837, 842:

> "There is a direction in this trust to distribute to the petitioners" (here the respondents) "not only income from the mining properties but also a portion of what Congress has considered part of the capital, part of the corpus, of the trust."

By the terms of the trust instrument in this case it became the property of the beneficiaries, and if it was given the character of part of the corpus in the hands of the trustees by the Act of Congress, it cannot be supposed that it was intended by Congress to be taxable in the hands of the beneficiaries.

3. It is further contended by the petitioner that the express allowance in section 219 and other sections of the statute of certain other deductions to the beneficiaries of a trust, by implication excludes the beneficiaries from the benefit of allowances to the trust estate, not made to them specifically. The provisions referred to offer no support for that implication for the reason, among others, that they relate to *credits* or deductions not included in section 214, and which are not otherwise allowed to estates held in trust. The contention of the respondent is that a deduction allowed the trust, from income payable by the trustee to the beneficiaries of the trust who are the real parties in interest, is in reality and effect an allow-

ance to the beneficiaries even though nominally made to the trustee, except as otherwise expressly stated. It is not otherwise expressly stated as to the allowance made for depletion. It is otherwise expressly stated as to one of the deductions allowed the trustee. That is, "*the amount of the income of the estate or trust for the taxable year is to be distributed currently by the fiduciary to the beneficiaries.*" But this, as stated above, is allowed the trustee *as an additional deduction* over and above the deductions allowed in sections 206 and 214 which are allowed *all individual taxpayers* in the computation of their taxable income. Also as stated above the allowance for depletion is allowed *as a return of capital*, and is not to be considered *income* as the term is used in the additional allowance. The *additional* allowance to the trustee, is merely a method of imposing the tax on the net income of the trust estate computed as provided in section 212 *directly* upon the beneficiaries of the trust, rather than *indirectly* as would be the case if the tax upon the net income of the trust estate so computed were required to be paid by the trustee. The only difference in the result is that by imposing the tax directly upon the beneficiaries their distributive shares of the net income of the trust estate are added to their other net income and are thereby taxed at the proper rate for each according to the bracket in which the added amounts may fall.

Much reliance is placed upon *Anderson vs. Wilson*, 289 U. S. 20, as a controlling authority against the decision of the court below in this case. It seems to us there is no analogy between that case and this. That decision was based upon the construction of the will involved in the case, which as held by the Court entitled the beneficiaries only to the income from the trust estate *pending*

*the time when the executors might in their discretion sell the corpus,* in which case, *what was given to them was the money forthcoming from the sale and nothing more.* The question in the case appears to have been, whether on a sale of the corpus by the trustees, the beneficiaries were entitled to take a deduction in their income tax returns for the shrinkage in the value of the property sold, between the time of the execution of the will and the discretionary exercise of the power of sale which was vested in the trustee. The court held they were not for the reason that they received upon the sale of the corpus all that was given to them by the will. The allowance of depletion in the instant cases is from the proceeds of a mine which by the terms of the trust instrument, belonged to the beneficiaries of the trust. The legal question here involved is practically identical with the question involved in *Reynolds vs. Cooper* (C. C. A. 10th Cir.) decided April 3, 1933, 64 Fed. (2d) 644, now before this court for review. In the opinion of the court in that case the decision in *Anderson vs. Wilson* which was relied on there by the government as a controlling authority, as it is here, was carefully considered and held to be inapplicable (64 Fed. (2) at page 644, 646, 647).

It is further said that because section 214 makes no express provision for any allowance of the deduction on account of depletion to the beneficiaries of a trust, but does provide that the allowance made for depletion shall be equitably apportioned between lessors and lessees, this shows that it was not intended that the beneficiaries should have the benefit of the deduction for depletion allowed to the trust. That provision of the statute merely affirms by legislative enactment what was previously held by this court to be the law in *Lynch vs. Alworth-Stephens Co.,* 267 U. S. 364. The interest of the lessee

is entirely distinct from that of the lessor, whereas the trustee is the representative of the beneficiaries who are the real parties in interest. There is therefor no sort of paralll between the case of lessor and lessee and that of trustee and *cestui que trust*, and the fact that express provision was made for an equitable apportionment of the allowance for depletion between lessor and lessee, can have no bearing on the question whether the beneficiaries of a trust in the absence of any express provision of the statute to the contrary are entitled to the benefit of deductions allowed the trust where the income of the trust estate from which the allowance is made, is distributable to them.

It is contended that Section 23 (1) of the 1928 Act expressly providing for apportionment of the allowable deduction for depletion in the case of property held in trust between the income beneficiaries and the trustee, changed the pre-existing law with respect to the rights of the beneficiaries, and in support of that contention reference is made to a congressional committee report incorporated in the appendix attached to the petitioner's brief. As against that we attach hereto Confidential Committee Print No. 1, and the report of the Senate Committee on Finance, May 1, 1928, amending the House Bill and recommending its passage as amended, and quote from the report of the Finance Committee, the following:

> "The House bill makes no change in existing law with respect to these deductions. The committee proposes to amend and clarify the law governing the manner in which the deductions shall be apportioned as between life tenant and remainderman or trustee and beneficiary. There is uncer-

> tainty and considerable hardship in these two classes of cases under the existing law."

In explanation of the bill in its relation to trusts it is further stated,

> "if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee. The bill contains similar provisions as to the deduction for depletion."

It is apparent on the face of section 23 (l) of the 1928 Act as that section was enacted, that it does not involve any change in the pre-existing law as to the rights of the beneficiaries in the matter of depletion. The grant of the *right to depletion* is in the first part of the section and is precisely the same as in the previous acts. What is added with reference to the case of property held in trust is that the allowable deduction in such cases "shall be apportioned between the income beneficiaries and the trustees in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each."

It would seem clear from the wording of this provision that its purpose was to clarify and make certain the law, particularly, in cases where because of provisions in the instrument creating the trust there is need for allocation of the income from the trust estate between the beneficiaries and the trustees for the taxable year.

The terms of the statute which required that in the case of mines a reasonable allowance shall be made in determining taxable income *are all inclusive*. To except from the application of the statute all cases of mines held in trust where the proceeds of their operation are distributable currently to the beneficiaries of the trust would be to import into the statute an exception that is not authorized by its terms. As said in the *Merle-Smith* case:

> "Nothing in the statutes differentiates 1917, 1918, 1919, 1920 and 1921 nor indicates that an allowance for depletion is limited to instances where the amounts are not received by virtue of a trust, or that royalties paid under a lease of mining property are taxable in the hands of beneficiaries of a trust to a greater extent than they would be in the hands of a fee owner of the properties" (pp. 841, 842).

III.

**Even if the deductions specified in sections 206 and 214 which are allowed the trust are included by the strict literal terms of section 219 in the additional deduction allowed the trustee, they must be excluded from the taxable income of the beneficiaries by construction.**

The objective in the interpretation or construction of statutes, is to ascertain the meaning and purpose of the statute.

"A court is not always confined to the written word. Construction sometimes is to be exercised as well as interpretation."

*U. S. vs. Farenholt,* 206 U. S. 226, 229.

All laws are to be given a sensible construction; and a literal application of a statute which would lead to absurd consequences should be avoided whenever a reasonable application may be given to it consistently with the legislative purpose.

*U. S. vs. Katz,* 271 U. S. 354.
*Re Chapman,* 166 U. S. 661.
*Hawaii vs. Maukichi,* 190 U. S. 197.

General terms in statutes should be so limited in their application as not to lead to injustice, oppression or absurd consequences. It will always, therefore, be presumed that the legislature intended exceptions to its language which would avoid results of this character. The reason of the law in such cases should prevail over the letter.

*U. S. vs. Kirby,* 7 Wall. 482.
*Church of the Holy Trinity vs. U. S.,* 143 U. S. 457.

The legislature will not be held to have done a vain and senseless thing if any other construction can legally be given to its acts.

*Clark vs. Barnard,* 108 U. S. 436.

The construction of section 219 contended for by the petitioner would lead to anomalous and unreasonable results and to unjust discrimination. The construction contended for by the petitioner, would except from allowance for depletion, *all cases of mines held in trust* where the net proceeds of the operation are currently distributable to the beneficiaries, whether the mine is operated by the trustees as the owners of the fee, or whether it is operated by a lessee under a lease from which the trustees receive royalties payable to the beneficiaries. Also whether or not the beneficiaries have a remainder interest in the mine itself following the termination of the trust.

In a foot note in petitioner's brief (p. 23) it is stated:

> "Since denial of the petition for a writ of certiorari in the *Merle-Smith* case, the Commissioner and the Board of Tax Appeals have both allowed deductions for depletion to the beneficiaries of trust who have a remainder interest in the corpus. *Alphin vs. Commissioner,* 21 B. T. A. 1101; *Kuhn vs. Commissioner,* 24 B. T. A. 216; G. C. M. 9804, X-2 Cumulative Bulletin 353; G. C. M. 10273, XI-1 Cumulative Bulletin 169."

There can, however, be no reason for any distinction in the case of a remainder interest if the contention of the petitioner that the allowance is made only to the fiduciary and does not inure to the benefit of the beneficiaries, is correct. To say that the deduction in the case of mines held in trust is allowed to the trustee, *means nothing* if

the deduction does not inure to the benefit of the beneficiaries who are entitled to receive the income from which the deduction is allowed to the trustee. The beneficiaries in such case are the taxpayers and the *only* parties in interest, as regards the allowance or disallowance of the deductions.

The fact that the proceeds of a mining operation are received by the taxpayer through the hands of a trustee who holds the legal title to the mine, is no reason for denying to such taxpayer the deduction for depletion which is allowed from similar income received by all other individual taxpayers. Such a discrimination would raise, at least; a serious question as to its constitutionality. It is without reason and could not be regarded otherwise than as purely arbitrary. Regardless of any constitutional question, it cannot be supposed that any such discrimination was intended by Congress.

## IV.

**The contention that the beneficiaries must have legal title to the ore reserve or some legal interest therein as distinct from equitable rights or a right to share in the proceeds of the exhaustion of the ore reserve is foreclosed by decisions of this court.**

*Palmer vs. Bender*, 53 S. Ct. 225.
*Lynch vs. Alworth-Stephens Co.*, 267 U. S. 364.
*Bryan vs. Kennett*, 113 U. S. 179.
*Croxall vs. Sheperd*, 5 Wall. 268.
*Irwin vs. Gavit*, 268 U. S. 161.

By the terms of the trust agreement the entire proceeds of the trust estate that come to the hands of the

trustees during the term of the trust belong to and become the property of the beneficiaries subject only to the right of the trustees to deduct expenses of administration (R. 90). The term of the trust was for two lives in being and 21 years thereafter from November 29, 1916 (R. 87). The term of the lease that remained after that date was upwards of 14 years (R. 99). For the purposes of the depletion rates allowable under the statute, the life of the mine was stipulated to be nine years (R. 99).

Upon the basis on which the depletion rates were computed the mine would be exhausted before the termination of the lease and long before the termination of the trust. There can therefore be no question in the case of a remainder interest in the ore reserves after the termination of the trust. Upon the facts stipulated, it cannot be assumed for the purposes of depletion allowances *during the term of the trust*, that there would be anything left of the ore reserves after the termination of the trust, when the life of the mine for the purposes of depletion allowances was stipulated to be only nine years and the trust extended for two lives and twenty-one years. The beneficiaries were thus not only by the terms of the trust instrument, the owners of the proceeds of the operation of the mine which came to the hands of the trustees during the term of the trust, but by the terms of the stipulation were, *ex hypothesi*, the *equitable owners* of the entire ore reserve subject to the lease.

As said by this court in *Irwin vs. Gavit*, 268 U. S. 161, 167, it was said:

> "A gift of the income of a fund ordinarily is treated by equity as creating an interest in the fund. Apart from technicalities, we can perceive

no distinction relevant to the question before us between a gift of the fund for life and a gift of the income from it."

And in *Croxall vs. Sheperd,* 5 Wall. 268, 281,

"In the consideration of a court of equity, the *cestui que trust* is actually seized of the freehold. * * * Generally, whatever is true at law of the legal estate, is true in equity of the trust estate."

In *Lynch vs. Alworth-Stephens Co.* 267 U. S. 364, 270:

"There is nothing" (in the Revenue Acts) "to suggest that the word 'property' is used in any restricted sense."

And in *Bryan vs. Kennett,* 113 U. S. 179, 192:

"The term 'property' as applied to lands, comprehends every species of title, inchoate or complete. * * * By the term 'property' applied to lands all titles are embraced, legal or equitable, perfect or imperfect."

In *Palmer vs. Bender,* 53 S. Ct. 225, 226, 227, the court said:

"That the allowance for depletion is not made dependent upon the particular legal form of the taxpayer's interest in the property to be depleted was recognized by this Court in Lynch vs. Alworth-Stephens Co., 267 U. S. 364, 45 S. Ct. 274, 69 L. Ed. 660. * * * Thus we have recently held that the lessor is entitled to a depletion allowance on bonus and royalties, although by the local law ownership of the minerals in place passed from

the lessor upon the execution of the lease. See Burnet vs. Harmel, supra; Bankers' Pocahontas Coal Company vs. Burnet, 287 U. S. ....., 53 S. Ct. 150, 77 L. Ed. ....., decided December 5, 1932" (pp. 226 and 227) (Italics ours).

The case of *Weiss vs. Weiner*, 279 U. S. 333, is relied on by the petitioner in support of the claim that the beneficiaries of a trust are not entitled to allowance for depletion. There is no analogy between that case and this. As stated in the opinion of the court, Weiner was in the business of taking long leases of property and subletting. The question involved was whether he should be allowed deduction from his income taxes for depreciation of the leased property. The court held that from the nature of the business in the course of which some of the leases were assigned and others surrendered to the lessor, it was uncertain whether he would sustain any loss from the depreciation of the leased property in a particular case, and in answer to the contention that the amount allowable for depreciation was capital and not income, the court said that the capital loss involved in the depreciation of the property was not shown to have been sustained by the lessee. The instant case is entirely different. The amount allowable for depletion is allowed as a *return* of capital and belonged to the beneficiaries of the trust in the hands of the trustees *even before it was distributed to them.* The question here is whether it was taxable as income in the hands of the beneficiaries when it was turned over to them by the trustees as required by the terms of the trust instrument. Or, regarding it as part of the gross income of the trust estate, whether its allowance as a deduction in computing the *taxable income of the trust,* does not exempt it from the

tax in the hands of the beneficiaries *as well as in the hands of the trustees.*

It is said that the beneficiaries had no investment in the trust. This is pure assumption without warrant in the record. It cannot be assumed that they did not give full value for what they received under the trust instrument. If assumption is to be indulged in, it may rather be assumed from the terms of the trust conveyance that they were the stockholders in the grantor corporation and that what they received under the trust was in lieu of their interest in the corporation as stockholders. From the fact that the depletion rates were computed on the basis of the ore reserves as of March 1, 1913 (R. 99, 100), it may be inferred that their interests related back prior to March 1, 1913, in which case the cost for income tax purposes would be the value as of March 1, 1913. By the terms of the trust instrument the conveyance of the trustees was in consideration of $1.00 and *other valuable consideration* (R. 82). This is inconsistent with any claim that the trust did not represent an investment in the trust estate, and whether the investment was by the trustees or by the beneficiaries of no importance for the purposes of the question involved. If the deduction for depletion was allowed to the trustees as a return of capital the question whether the beneficiaries had any actual investment in the corpus of the trust estate or not, can have no bearing on the question whether what was allowed to the trustees as a return of capital is taxable as income in the hands of the beneficiaries by virtue of its distribution to them as required by the terms of the trust instrument. Whatever was distributed to the beneficiaries of the trust by the trustees from what was allowed to them as a return of capital or as a part of the corpus, should not be taxable in the hands of the benefi-

ciaries regardless of whether they had any investment in the corpus of the trust or not. There is, however, no question of the amount of the investment of the beneficiaries in the corpus of the trust before the court in this case. As appears from the record, no such question was raised either before the Board of Tax Appeals or in the court below.

As said in the opinion of the Board of Tax Appeals:

> "The sole issue presented by these proceedings is whether the beneficiaries of a trust are entitled to deductions for depletion because of iron ore removed from property forming a part of the trust corpus" (R. 101, 102).

And in the opinion of the court below:

> "The amounts of the sums deducted for such purpose" (depletion) "and disallowed by the Board is not in controversy, and the sole question is whether petitioners were entitled to deduct the said items in making up their tax returns" (R. 117).

As said in *Edward Hines Yellow Pine Trustees vs. Martin*, 268 U. S. 458, 465:

> "This court is a court of review and it will not consider questions not raised or disclosed by the record brought to it for a review and which were not considered by the courts below."

It is stated in petitioner's brief (p. 5):

> "The amount of depletion to which the respondents are entitled, if such a deduction is allowable, has been stipulated and is not in dispute (R. 80, 99-100)."

All of the factors required *for the determination of the amount* of allowable depletion are impliedly included in the stipulation.

The specification of errors as stated in the petition for certiorari and repeated in the brief for petitioner filed herein, is that the Circuit Court of Appeals erred:

> "1. In holding that the respondents were entitled to a deduction for depletion of a mine constituting the corpus of a trust from which they received distributions of income.
>
> 2. In failing to hold that there is no statute authority in the Revenue Acts of 1921, 1924 and 1926 for the allowance of a deduction for depletion to beneficiaries of a trust who received distributions of trust income but have no remainder interest in the corpus of the trust."

Manifestly no question as to the amount of the investment of the beneficiaries in the trust, is raised by the above specifications, and no error of the court below could be assigned for review by this court, *with respect to a question not raised or considered in the court below.*

In conclusion it is respectfully submitted that the judgment of the court below should be affirmed.

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# APPENDIX.

## Confidential Committee Print No. 1

(April 27, 1928)

70TH CONGRESS
1st Session

Calendar No.

H. R. 1
(Report No. .....)

IN THE SENATE OF THE UNITED STATES

December 17, 1927

Read twice and referred to the Committee on Finance.
April ...., 1928

Reported by Mr. Smoot, with amendments

(Omit the part struck through and the part inclosed in bold-face brackets and insert the part printed in italic.)

AN ACT

To reduce and equalize taxation, provide revenue, and for other purposes.

* * * * * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(1) DEPLETION.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each

case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the cases of leases the deduction ~~allowed by this subsection~~ shall be equitably apportioned between the lessor and lessee. *In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the propetry and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or; in the absence of such provisions, on the basis of the trust income allocable to each.* (For percentage depletion in case of oil and gas wells, see section 114(b)(3).)

**Calendar No. 987**

70th CONGRESS 1st Session — SENATE — REPORT No. 960

## INTERNAL REVENUE BILL OF 1928

May 1, 1928.—Order to be printed

Mr. Smoot, from the Committee on Finance, submitted the following

## REPORT

(to accompany H. R. 1)

The Committee on Finance, to whom was referred the bill (H. R. 1) to reduce and equalize taxation, to provide revenue, and for other purposes, having had the same under consideration, report favorably thereon, with cer-

tain amendments, and as amended recommend that the bill do pass.

* * * * * * *

SEC. 23(K) and (L). DEPRECIATION AND DEPLETION—LIFE ESTATES AND TRUSTS (p. 20)

The House bill makes no change in existing law with respect to these deductions. The committee proposes to amend and clarify the law governing the manner in which the deductions shall be apportioned as between life tenant and remainderman or trustee and beneficiary. There is uncertainty and considerable hardship, in these two classes of cases under the existing law.

In the case of life tenant and remainderman the bill provides that the deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property—that is, in accordance with the estimated useful life of the property—and shall be allowed to the life tenant each year that he holds the property. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is allocable to the trustee and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first

make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee. The bill contains similar provisions as to the deduction for depletion.

A clerical change is made in section 24(b) of the bill to obviate any conflict between that section and the provisions of sections 23(k) and 23(l).

# SUPREME COURT OF THE UNITED STATES.

No. 225.—October Term, 1933.

| | |
|---|---|
| Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Otto H. Falk, et al., Executors of the Estate of Charles F. Pfister, Deceased. | On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit. |

[January 15, 1934.]

Mr. Justice McReynolds delivered the opinion of the Court.

The Bristol iron ore mine in Michigan, while subject to a fourteen year lease providing for royalties of nineteen cents per ton, was conveyed to three trustees to hold during two lives and twenty-one years with power to manage, sell, lease, mortgage or otherwise dispose thereof. After providing for payment of taxes, expenses, etc., the deed directed:

> Except as above authorized to be expended, paid out or retained, all proceeds which shall come to the hands of the Trustees from said property or from any use which may be made thereof, or from any source whatsoever hereunder as received by the Trustees shall belong to and be the property of the beneficiaries hereunder to be distributed and paid over to them in proportion to and in accordance with their respective interests as shown herein, or as the same shall from time to time appear as hereinafter provided.

Respondents are the beneficiaries under the deed and owners of the entire economic interest in the mine. Its life was estimated as nine years. Proper depletion allowance would be 13.255 cents per ton of ore extracted.

During the years 1922 to 1926 the trustees collected large sums as royalties. After deducting expenses they distributed what remained among the beneficiaries. Claims for depletion made by the trustees in their tax returns were disallowed.

Each beneficiary claimed the right to deduct from the total received his proportionate share of the depletion. This, he maintained, was not subject to taxation under the statute. The Commissioner demanded payment reckoned upon the whole amount; and the Board of Tax Appeals accepted his view. The court below thought otherwise and sustained the taxpayers.

There is no substantial dispute concerning the facts. Our decision must turn upon construction of the statute.

The Revenue Act of 1921, c. 136, 42 Stat. 227, 239, 242, 246, 247, imposes a tax upon the net income of property held in trust, Secs. 210, 211, 219, and directs that in order to determine this there shall be deducted from gross "in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case." Sec. 214 (a) (10).

Also it requires the fiduciary to make return of the income of the trust Sec. 219 (b), and provides that whenever income must be distributed to beneficiaries periodically the amounts paid out shall be allowed as an additional deduction in computing the net income of the trusts. In the latter event there shall be included in computing the net income of each beneficiary so much of the income of the trust as he has received. Sec. 219 (e).*

The relevant provisions of the Revenue Acts of 1924 (c. 234, 43 Stat. 253, 269, 272, 275) and 1926 (c. 27, 44 Stat. 9, 26, 28, 32) are substantially the same as those in the Act of 1921.

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*Revenue Act, 1921, c. 136, 42 Stat. 227, 247.

Sec. 219 (e). In the case of an estate or trust the income of which consists both of income of the class described in paragraph (4) of subdivision (a) of this section and other income, the net income of the estate or trust shall be computed and a return thereof made by the fiduciary in accordance with subdivision (b) and the tax shall be imposed, and shall be paid by the fiduciary in accordance with subdivision (c), except that there shall be allowed as an additional deduction in computing the net income of the estate or trust that part of its income of the class described in paragraph (4) of subdivision (a) which, pursuant to the instrument or order governing the distribution, is distributable during its taxable year to the beneficiaries. In cases under this subdivision there shall be included, as provided in subdivision (d) of this section, in computing the net income of each beneficiary, that part of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is determinable during the taxable year to such beneficiary.

The argument for the Commissioner is this—The entire proceeds from the working of a mine constitute income within the Constitutional provision and may be subjected to taxation without regard to depletion. Here the beneficiary claims deduction for an item subject to taxation as gross income; but no provision in the statute allows him to subtract anything because of depletion.

Moreover, Sec. 219 expressly requires every beneficiary to include in his return the portion of the income of a trust distributed to him. Thus in terms he is subjected to taxation upon the whole of this.

Whatever may be said concerning the power of Congress to treat the entire proceeds of a mine as income, obviously this statute has not undertaken so to do. The plain purpose, we think, was to tax only that portion of the proceeds remaining after proper allowance for depletion. This allowance represents property consumed, is treated as if capital assets, and no tax is laid upon it. The statute must be so applied in practice as to carry out this purpose. The intention was that owners of beneficial interests should not be unduly burdened.

Since 1913 all Revenue Acts have left untaxed the proceeds of a mine so far as these represent actual depletion. And this court has often recognized that this immunity enures to the beneficial owners of the economic interest.

*Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364, 370. "The plain, clear and reasonable meaning of the statute seems to be that the reasonable allowance for depletion in case of a mine is to be made to every one whose property right and interest therein has been depleted by the extraction and disposition 'of the product thereof which has been mined and sold during the year for which the return and computation are made.'"

*United States* v. *Ludey*, 274 U. S. 295, 302. "The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any year represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material in making the product of a manufacturing establishment. As the cost of the raw material must be deducted from the gross income before the net income can be determined, so the estimated cost of the part of the reserve used up is allowed."

*Murphy Oil Co.* v. *Burnet*, 287 U. S. 299, 302. "We think it no longer open to doubt that when the execution of an oil and gas lease is followed by production of oil, the bonus and royalties paid to the lessor both involve at least some return of his capital investment in oil in the ground, for which a depletion allowance must be made."

*Palmer* v. *Bender, Administratrix*, 287 U. S. 551, 557. "That the allowance for depletion is not made dependent upon the particular legal form of the taxpayer's interest in the property to be depleted was recognized by this Court in *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364. . . . But this Court held that regardless of the technical ownership of the ore before severance, the taxpayer, by his lease, had acquired legal control of a valuable economic interest in the ore capable of realization as gross income by the exercise of his mining rights under the lease. Depletion was, therefore, allowed. Similarly, the lessor's right to a depletion allowance does not depend upon his retention of ownership or any other particular form of legal interest in the mineral content of the land. It is enough if, by virtue of the leasing transaction, he has retained a right to share in the oil produced. If so he has an economic interest in the oil, in place, which is depleted by production."

*Freuler, Adm.*, v. *Helvering, Commissioner* (January 8, 1934), construed Section 219. We there said—"Plainly the section contemplates the taxation of the entire net income of the trust. Plainly, also, the fiduciary, in computing net income, is authorized to make whatever appropriate deductions other taxpayers are allowed by law. The net income ascertained by this operation, and that only, is the taxable income. . . . But as the tax on the entire net income of the trust is to be paid by the fiduciary or the beneficiaries or partly by each, the beneficiary's share of the income is considered his property from the moment of its receipt by the estate. . . . For the purpose of imposing the tax the Act regards ownership, the right of property in the beneficiary, as equivalent to physical possession. . . ."

True it is that Sec. 219 (b) directs that in cases of "income which is to be distributed to the beneficiaries periodically," . . . "the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary that part

of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary." But we cannot accept the view that this was intended to impose a tax upon that part of the proceeds which represents the return of capital assets, whenever this has been paid over to the beneficiary. In cases like the one before us so to hold would in practice result in taxing allowances for depletion, contrary to what we regard as the plain intent of the statute.

The petitioner relies upon *Anderson, Collector* v. *Wilson*, 289 U. S. 20, 26. The conclusion there rests upon the construction of the will. Under it the beneficiaries became entitled to no income until the executors in their discretion should sell the corpus. "What was given to them was the money forthcoming from a sale. . . . Their interest in the corpus was that and nothing more. . . . A shrinkage of values between the execution of the power of sales and its discretionary exercise is a loss to the trust, which may be allowable as a deduction upon a return by the trustees. It is not a loss to a legatee who has received his legacy in full."

Here the governing instrument directed payment to the beneficiaries of the entire proceeds, less expenditures, etc., and the trustees must be regarded as a mere conduit for passing them to the beneficial owners. Part only of the proceeds was subjected to taxation. The other part was left untaxed and remained so in the hands of the beneficiaries.

*Affirmed.*

A true copy.

Test:

*Clerk, Supreme Court, U. S.*

# SUPREME COURT OF THE UNITED STATES.

No. 225.—October Term, 1933.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,
*vs.*
Otto H. Falk, et al., Executors of the Estate of Charles F. Pfister, Deceased.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[January 15, 1934.]

Mr. Justice Stone.

I think the judgment should be reversed.

By a trust created by the lessor of a mine, the trustees were authorized to collect the stipulated cash royalties of 19¢ per ton on ore mined, and to distribute them to the beneficiaries, who are the taxpayers here, without setting up any reserve for depletion of the lessor's capital investment in the mine. The beneficiaries were given no other interest in the trust property or its income. It is not denied that the entire amount thus received by them is income which may be taxed. See *Burnet* v. *Harmel*, 287 U. S. 103, 107, 108; *Bankers Pocahontas Coal Co.* v. *Burnet*, 287 U. S. 308, 310; *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103, 114; cf. *Lynch* v. *Hornby*, 247 U. S. 339. And the tax is imposed on the entire amount received, subject only to such deductions as the statute permits. The sole question to be decided is whether they are entitled to the benefit of the statute authorizing the taxpayer, in computing the tax, to deduct from income "a reasonable allowance for depletion and for depreciation of improvements according to the peculiar conditions in each case".

As the statute permits the deduction only because the allowance represents a return to the taxpayer, in the form of income, for some part of his capital worn away or exhausted in the process of producing the income, see *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299; *Bankers Pocahontas Coal Co.* v. *Burnet, supra; United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, it would seem plain that there is no occasion for a depletion allowance, and that the statute authorizes none where as here the taxpayer, a donee of the income,

has made no capital investment in the property which has produced it. This was not doubted where the deduction claimed, but denied, was for depreciation, *Weiss* v. *Wiener,* 279 U. S. 333, and it was only because the court concluded that the taxpayer had made a capital investment, represented by the minerals in place, that he was permitted to deduct an allowance for depletion from royalties received from the production of an oil well in *Palmer* v. *Bender,* 287 U. S. 551, and of a mine in *Lynch* v. *Alworth-Stephens Co.,* 267 U. S. 364. The function of the allowance for depletion as a means of securing to the taxpayer a credit against gross income for so much of his capital investment as is restored from the income does not differ from that for depreciation or obsolescence when allowed as a deduction. See *United States* v. *Ludey,* 274 U. S. 295; *Gambrinus Brewery Co.* v. *Anderson,* 282 U. S. 638; *United States* v. *Dakota-Montana Oil Co., supra.* Legally and economically the statutory allowances for depletion and depreciation stand on the same footing. Both are means of restoring capital invested, the one, in ore, the other, in structures and improvements. Both are allowed by the same language in a single statute. Neither has any function to perform if the taxpayer has made no investment to be restored from income received. The incongruity of allowing the deduction for depletion where the taxpayer has made no capital investment but denying it for depreciation is apparent.

The income here, derived from mining royalties, cannot be said to be a return of the taxpayer's capital because if paid to the lessor it would have restored to him some part of his capital investment. The lessor, by directing that the royalties be distributed to the beneficiaries, cut himself off from the enjoyment of the privilege which the statute gives to restore his capital investment from royalties, and he has denied that privilege to the trustees. The taxpayer may not claim the benefit of a deduction which the statute grants to another, *Dalton* v. *Bowers,* 287 U. S. 404; *Burnet* v. *Clark,* 287 U. S. 410; *Burnet* v. *Commonwealth Improvement Co.,* 287 U. S. 415, and the petitioners are in no better position to claim the privilege because the lessor, to whom it was given, has relinquished it.

Mr. Justice BRANDEIS and Mr. Justice CARDOZO concur in this opinion.